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OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

v.

INVESTMENT COMPANY INSTITUTE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Solicitor General, on behalf of the Board of Governors of the Federal Reserve System, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINION BELOW

The opinion of the court of appeals (App. A, *infra*, 1a-47a, 48a-49a) is not yet reported.

JURISDICTION

The judgment of the court of appeals (App. B, *infra*, 50a) was entered on March 30, 1979. A petition for rehearing was denied on July 16, 1979

(App. C, *infra*, 51a-52a). On October 11, 1979, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including December 13, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, under Section 4(c)(8) of the Bank Holding Company Act, the Federal Reserve Board may authorize bank holding companies to organize and manage closed-end investment companies to the extent permitted by the Glass-Steagall Act.

STATUTES AND REGULATIONS INVOLVED

Pertinent statutory and regulatory provisions are set forth in Appendices F and G, *infra*, 80a-87a, 88a-91a.

STATEMENT

1. The Statutory Framework

Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. 1843(c)(8), authorizes bank holding companies to acquire "shares of any company the activities of which the [Federal Reserve] Board * * * has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto."[1] The

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[1] A "bank holding company" is defined in Section 2(a)(1) of the Act, 12 U.S.C. 1841(a)(1), as "any company which has control over any bank or over any company that is or becomes a bank holding company * * *." Section 2(a)(2) of the Act, 12 U.S.C. 1841(a)(2), provides that "[a]ny company has control over a bank * * * if [*inter alia*] * * *

Banking Act of 1933, ch. 89, 48 Stat. 162, contains several provisions (collectively referred to as the Glass-Steagall Act) that restrict participation by banks and affiliates of banks, such as bank holding companies and their nonbank subsidiaries, in specified securities activities. The Glass-Steagall Act prescribes different rules for banks and bank holding companies.

Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, prohibits affiliates of member banks [2] from engaging "principally" in the issuance, sale, or distribution of securities. Section 20 expressly applies to holding companies of member banks. 12 U.S.C. 221a(b).

The limitations imposed by the Glass-Steagall Act on the securities activities of banks are stricter than those imposed on affiliates such as bank holding companies. Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, provides that national banks may not underwrite any issue of securities or stock. Section 16 also provides that national banks may buy and sell certain categories of securities only for the accounts of customers and not for their own account.[3] In addition, Section 21 of the Glass-Steagall Act, 12 U.S.C. 378, forbids organizations engaged in the business of issuing, underwriting, selling, or distributing

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the company * * * owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank * * *."

[2] Every national bank is required to be a member of the Federal Reserve System. 12 U.S.C. 282. A state-chartered bank may become a member bank upon application to, and approval by, the Board. 12 U.S.C. 321.

[3] State member banks are subject to the same restrictions that are applicable to national banks. 12 U.S.C. 335.

securities to engage in the business of receiving deposits—the business of banking.

2. The Board's Regulation and Interpretive Reading

On January 20, 1972, the Federal Reserve Board promulgated a regulation which provides that serving as an investment adviser to a registered investment company [4] is an activity "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act and is therefore permissible for bank holding companies.[5] 12 C.F.R. 225.4(a)(5)(ii) (App. F, *infra*, 81a).[6] An accom-

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[4] The definition of "investment company" contained in the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, includes companies engaged primarily in the business of investing in securities. See 15 U.S.C. 80a-3(a). Certain investment companies are required to register with the Securities and Exchange Commission. 15 U.S.C. 80a-7, 80a-8.

[5] The Board's determination that an activity is "closely related to banking" does not, in itself, authorize any particular bank holding company to engage in that activity. A bank holding company must apply to the Board for permission to undertake such activity; the Board is then required to determine whether the public benefits resulting from the performance of the activity by the particular holding company outweigh any possible adverse effects. 12 U.S.C. 1843(c)(8). The Board also has authority to supervise holding companies so engaged to prevent the violation of federal law or regulation and to assure sound banking practices. 12 U.S.C. 1818(b)(1), (3); 92 Stat. 3646.

[6] The Board's regulation authorizing bank holding companies to serve as investment advisers increased the types of fiduciary services that holding companies might provide. The Board has also authorized fiduciary-type services such as advising real estate investment trusts, providing portfolio

panying interpretive ruling, 12 C.F.R. 225.125 (see App. F, *infra*, 83a-87a), sets forth the limitations that the Board concluded must be imposed on bank holding companies serving as investment advisers to comply with the Glass-Steagall Act, as construed by this Court in *Investment Co. Institute* v. *Camp*, 401 U.S. 617 (1971). In light of *Camp*, the Board determined that certain activities ordinarily performed by investment advisers on behalf of investment companies are permissible, while others are prohibited.[7]

The Board's interpretive ruling draws a distinction between open-end and closed-end investment companies. The ruling prohibits a bank holding company serving as an investment adviser from organizing or controlling an open-end investment company, which typically stands ready to sell and redeem its shares at any time and thus is continuously engaged in the process of issuing securities. 12 C.F.R. 225.125(f), (c).[8] Closed-end investment companies, in contrast,

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investment advice, furnishing general economic information, and providing financial advice to state and local governments. 12 C.F.R. 225.4(a)(5)(i)-(v).

[7] In its interpretive ruling, the Board stated its view that the Glass-Steagall Act was not modified by the Bank Holding Company Act Amendments of 1970 and that, accordingly, the Glass-Steagall Act's restrictions on securities activities of bank affiliates must be applied to bank holding companies serving as investment advisers. 12 C.F.R. 225.125(b), (e), (f).

[8] Open-end investment companies are commonly known as "mutual fund[s]." *Investment Co. Institute* v. *Camp, supra*, 401 U.S. at 625 n.11. Under the Board's interpretive ruling, bank holding companies may only provide investment advice to, as distinguished from organizing or controlling, open-end investment companies. 12 C.F.R. 225.125(c), (f).

do not stand ready to redeem their shares and do not issue their shares after initial organization except at infrequent intervals. In light of this difference, the Board's interpretive ruling permits bank holding companies to organize or control closed-end investment companies, with the caveat that such management activities are permissible only if the investment company is not primarily or frequently engaged in the issuance of securities. 12 C.F.R. 225.125(f), (c). In addition, the Board's interpretive ruling expressly prohibits bank holding companies from engaging directly or indirectly in the sale or distribution of any securities issued by *any* investment company. 12 C.F.R. 225.125(h).

The interpretive ruling also imposes restrictions designed to eliminate potential conflicts of interest and unsound banking practices of the types discussed by this Court in *Investment Co. Institute* v. *Camp, supra*, 401 U.S. at 630-634, 636-639. Bank holding companies and their subsidiaries are forbidden to purchase for their own account securities of any investment companies that receive investment advice from such holding companies, and they are also forbidden to purchase such securities for any other person in a discretionary fiduciary capacity. Holding companies and their subsidiaries are also forbidden to extend credit to any such investment companies or to accept their securities as collateral except under limited circumstances. 12 C.F.R. 225.125(g). In order to insure their complete separation from in-

vestment banking, bank holding companies are likewise forbidden to distribute prospectuses or sales literature concerning their advisee investment companies, and such materials may not be made available at offices of the holding companies. Officers of bank subsidiaries may not express opinions concerning the shares of such investment companies, and the names of bank customers may not be furnished to investment companies or their representatives. The Board's interpretive ruling also strictly limits the making of cash deposits on behalf of an advisee investment company in any subsidiary bank of the adviser holding company. 12 C.F.R. 225.125(h), (i).

3. Respondent's Challenge to the Board's Regulation and Interpretive Ruling

In December 1973 respondent Investment Company Institute, a trade association of open-end investment companies, requested the Board to rescind its regulation and interpretive ruling. Respondent alleged that the regulation permitted activities that violate Sections 16 and 21 of the Glass-Steagall Act and therefore could not be authorized by the Board under the Bank Holding Company Act. In March 1974 and again in August 1977 the Board denied this request to rescind the regulation (Apps. D, E, *infra*, 53a-64a, 65a-79a).[9] The Board reaffirmed that, subject to the

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[9] Respondents filed a second petition for rescission of the Board's regulation after an initial attempt to obtain judicial review was denied on jurisdictional grounds. See *Investment Co. Institute* v. *Board of Governors of the Federal Reserve System*, 398 F. Supp. 725 (D.D.C. 1975), aff'd, 551 F.2d 1270 (D.C. Cir. 1977).

restrictions prescribed in its interpretive ruling, bank holding companies could serve as investment advisers to closed-end investment companies without infringing the Glass-Steagall Act. The Board also emphasized the close connection between traditional fiduciary services offered by banks and the provision of investment management services to closed-end investment companies: "banks historically have furnished investment advice to trust accounts; these include testamentary trusts, *inter vivos* trusts, executorships and guardianships, managing agency accounts and pension and profit sharing trusts. In all of these traditional trust activities, banks place orders with independent broker-dealer firms to buy and sell stocks and other securities" (App. D, *infra*, 62a).

The court of appeals, on review of the Board's order denying respondent's request for rescission, set aside the Board's regulation and interpretive ruling (App. A, *infra*, 3a, 47a). At the outset, the court of appeals rejected respondent's contention that organization or control of a closed-end investment company by a bank holding company violates the Glass-Steagall Act (*id.* at 14a-23a). Nonetheless, even though neither respondent nor any other party had directly raised the issue in any forum, the court concluded that the challenged regulation and interpretive rule exceeded the Board's authority under Section 4(c)(8) of the Bank Holding Company Act (App. A, *infra*, 23a-46a).

The court found "virtually no guidance" on this question in the legislative history of the Bank Holding Company Act as originally enacted in 1956 (App. A, *infra*, 30a). It concluded, however, that the Act's grant of authority in 1956 to bank holding companies to engage in "financial" and "fiduciary" activities closely related to the business of banking (70 Stat. 137) could not be construed to permit the management of closed-end investment companies because of the generally understood policy of the Glass-Steagall Act to divorce "investment from commercial banking" (App. A, *infra*, 30a). The court also concluded that the 1970 amendments to the Bank Holding Company Act (84 Stat. 1763) could not support the Board's regulation because Congress, at the time of enactment of the 1970 amendments, *believed* that the Glass-Steagall Act prohibited bank holding companies from operating closed-end investment companies. The court reached this conclusion even though it rejected respondent's contention that the Glass-Steagall Act *in fact* had such a preclusive effect (App. A, *infra*, 43a-44a).[10]

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[10] After handing down its opinion, the court issued an order amending the opinion by adding a sentence stating that the court was withholding judgment on the question whether bank holding companies and their nonbank subsidiaries may "render solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies" (App. A, *infra*, 48a-49a).

REASONS FOR GRANTING THE PETITION

1. This case presents the important question whether Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. 1843(c)(8), a provision authorizing bank holding companies to engage in activities "closely related to banking" as approved by the Federal Reserve Board, should be construed to forbid fiduciary-type activities of bank holding companies that are not prohibited by the Glass-Steagall Act. As a part of their ordinary banking business, banks have traditionally provided a wide range of fiduciary and financial advisory services that involve transactions in securities. The conclusion of the court of appeals that investment management services rendered to closed-end investment companies cannot be deemed "closely related to banking," despite their similarity to various fiduciary services provided by banks, is of great consequence not only to the bank holding companies that render such services but also to members of the public who invest in closed-end companies. The court's decision would require bank holding companies now engaged in such activities to terminate their involvement and would insulate other investment managers from future competition from bank holding companies.[11]

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[11] In addition, by holding that the organization and management of closed-end investment companies is not "closely related to banking," the decision calls into serious question the permissibility of such activities for banks, whose powers are by definition narrower than those of bank holding companies under 12 U.S.C. 1843(c)(8).

Banking organizations have traditionally been an important source of investment advice and management for investment companies.[12] At present, banking organizations manage ten closed-end investment companies, about one-sixth of all of the major closed-end investment companies. The total net assets of the closed-end investment companies so managed are valued at approximately $670 million.[13] In addition, the holding of the court of appeals prohibits any future entry by bank holding companies into this field.[14]

The control and organizational activities forbidden by the decision of the court of appeals are important functions of investment advisers. Investment companies are ordinarily organized and operated by their investment advisers.[15] As this Court explained in *Burks* v. *Lasker*, No. 77-1724 (May 14, 1979), slip op. 9, most investment companies are "formed" and

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[12] In 1976, the largest 115 banks and their nonbank affiliates provided some form of investment advice to 159 investment companies (16% of all registered investment companies) which held assets of over $6 billion. See SEC Final Report on Bank Securities Activities 146-148 (1977).

[13] See Wiesenberger, *Investment Companies Service*, "Management Results" (September 1979). Respondent's challenge to the Board's regulation has been pending almost continuously since 1973 and has undoubtedly deterred some bank holding companies from seeking to become investment advisers to closed-end investment companies.

[14] At year end 1978, there were 2,222 registered bank holding companies in operation. See Board of Governors of the Federal Reserve System Annual Report 358 (1978).

[15] See 12 C.F.R. 225.125(e).

"managed" by external investment advisers that "select the funds' investments and operate their businesses." See also *Tannenbaum* v. *Zeller*, 552 F.2d 402, 405 (2d Cir. 1977). By prohibiting bank holding companies from organizing closed-end investment companies,[16] the decision of the court of appeals will curtail the creation of new closed-end companies.

Moreover, as we have noted above, to the extent that the court of appeals intended to prohibit discretionary investment management and its ordinary incidents, the decision below will effectively preclude bank holding companies (and perhaps banks as well) from serving as investment advisers to closed-end companies that have already been formed, since discretionary investment authority is an essential advisory function.[17] To be effective, the adviser must itself be able to purchase and sell investments on behalf of its advisee, as well as perform other administrative and custodial services in connection with the management of the company's portfolio. Bank holding company investment advisers will not be able to compete effectively if limited to providing a list of suggested investments to advisee investment companies. The limitations imposed by the decision of

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[16] The Board's regulations do not permit bank holding companies to organize open-end investment companies (mutual funds). See 12 C.F.R. 225.125(f).

[17] See *SEC Institutional Investor Study Report*, H.R. Doc. No. 92-64 (Part 2), 92d Cong., 1st Sess. 167, 266-270 (1971) (75% of registered investment companies delegate "sole investment authority" to their investment advisers).

the court of appeals therefore have substantial practical importance.[18]

2. The decision of the court of appeals rests on a misconstruction of the plain meaning of Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8). As this Court has frequently pointed out, the primary guide in a case of statutory construction is the language of the statute itself. *Touche Ross & Co.* v. *Redington*, No. 78-309 (June 18, 1979), slip op. 7; *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977). By its terms, Section 4(c)(8) provides that bank holding companies may engage in activities that the Board has determined to be "closely related to banking." The statute does not define the activities that are permissible, and it does not proscribe any activities. Rather, it delegates the process of delineation to the expert agency. The lower courts have consistently held that Section 4(c)(8) leaves to the discretion of the Board the task of defining precisely which activities are permissible.[19]

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[18] Bank holding companies also furnish investment advisory services similar to those at issue here (under regulatory provisions not directly challenged in this litigation) to investment funds other than investment companies. See note 6, *supra*. These investment vehicles, including real estate investment trusts, small business investment companies, and pooled employee benefit plans, are often structured similarly to closed-end investment companies. The reasoning of the court of appeals could be extended to prohibit these customary services of bank holding companies and their subsidiaries.

[19] *National Courier Ass'n* v. *Board of Governors of the Federal Reserve System*, 516 F.2d 1229, 1237 (D.C. Cir. 1975); *Alabama Ass'n of Insurance Agents* v. *Board of Gov-*

Section 4(c)(8) does not, on its face, exclude securities-related activities from the realm of activities that are closely related to banking. And since Congress has long authorized national banks to serve in various fiduciary capacities involving securities transactions (see 12 U.S.C. 92a), no such limitation can logically be implied.[20] Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, however, expressly prohibits bank affiliates, including bank holding companies, from engaging "principally" in the issuance or distribution of securities. As a result, the Board is empowered by Section 4(c)(8) to authorize fiduciary-type activities to the extent not prohibited by Section 20 of Glass-Steagall—that is, only to the extent that the bank holding company is not authorized to engage "principally" in the issuance or distribution of securities.

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ernors of the Federal Reserve System, 533 F.2d 224 (5th Cir. 1976), modified on other grounds, 558 F.2d 729 (5th Cir. 1977), cert. denied, 435 U.S. 904 (1978); see also *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors of the Federal Reserve System*, 568 F.2d 549 (7th Cir. 1978).

[20] Commercial banks today, operating through trust departments, are the nation's largest institutional investors. See *SEC Institutional Investor Study Report, supra*, at 413-494. At the end of 1978, trust departments of insured commercial banks held over $441.8 billion in assets. American Banker, Nov. 16, 1979, at 1, col. 1. Bank trust departments administer common trust funds, employee benefit trusts, institutional and corporate agency accounts, as well as personal trust and agency accounts. See *SEC Institutional Investor Study Report, supra*; see also 12 C.F.R. 9.18 (prescribing rules for collective investment funds operated by national bank trust departments).

The Board acted reasonably and in accordance with law in finding that the organization and management of closed-end investment companies, as circumscribed by the Board's regulation and interpretive ruling, are activities "closely related to banking" under Section 4(c)(8) and do not result in bank holding companies becoming "engaged principally" in the issuance or distribution of securities. A bank holding company serving as an adviser to a closed-end investment company is engaged principally in furnishing advice concerning the purchase or sale of securities and certain incidental services related to the day-to-day operation of the investment company.[21] Under the Board's regulation, such advisers are forbidden to engage directly or indirectly in the process of underwriting, distributing, or promoting the investment company's shares. 12 C.F.R. 225.125(h). The limited services that are permitted are functionally the same as those provided by banks through their own trust departments, which undoubtedly may organize, manage, and give advice to common trust funds that contain the aggregated assets of a number of individual trusts.

Because the Board's regulation authorizes a bank holding company to organize and manage only closed-end investment companies that issue securities infrequently, and because the holding company must be segregated from the underwriting process under the Board's regulation, the bank holding company is not

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[21] Such services may include providing the investment company with personnel, office space, and clerical and administrative assistance.

permitted to engage *principally*, if at all, in the issuance of securities.[22] The type of activity permitted under the Board's regulation is that of the fiduciary —a role common to commercial banks—not that of the investment banker.

The structure of the Bank Holding Company Act also confirms that Congress did not intend to prohibit bank holding companies from operating closed-end investment companies. Section 4(c)(7) of the Act, 12 U.S.C. 1843(c)(7), expressly permits a bank holding company to acquire all (or part of) the shares of an investment company and to manage, control, and advise its subsidiary investment company.[23] In light of this provision,[24] it is difficult to contend that Congress believed investment company management

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[22] The Board has consistently distinguished between closed-end and open-end investment companies in applying the Glass-Steagall Act. See 12 C.F.R. 218.101 (1951 interpretation); 12 C.F.R. 218.102 (1960 interpretation).

[23] Under Section 4(a)(2)(A) of the Act, 12 U.S.C. 1843(a)(2)(A), a bank holding company is empowered to manage, control, and provide services to its subsidiaries, including an investment company subsidiary.

[24] While Congress was evidently considering the case of a wholly owned investment company when Section 4(c)(7) was enacted, see 102 Cong. Rec. 6853 (1956) (remarks of Sen. Robertson), the language of Section 4(c)(7) authorizes bank holding companies to acquire all or part of the stock of an investment company, and the legislative history indicates that the section was intended to apply to any investment company meeting the specified requirements. Thus, Section 4(c)(7) permits a holding company to manage an investment company in which other investors also have an interest.

to be a forbidden activity under the flexible standard of Section 4(c)(8).

3. Instead of construing the literal text of the statute, the court of appeals placed principal reliance on legislative history (App. A, *infra*, 24a-25a). However, the legislative history does not support the court's conclusion. The relevant history shows that Congress intended to leave to the Board the responsibility for designating those activities involving securities transactions that are permissible for bank holding companies subject to Glass-Steagall Act limitations. The legislative history also shows that Congress believed that investment advisory services for investment companies could be authorized by the Board subject to the restrictions of the Glass-Steagall Act.

As the court of appeals recognized (App. A, *infra*, 39a-40a), a prohibition in the House version of the 1970 amendments to the Bank Holding Company Act that would have precluded the Board from permitting holding companies to operate investment companies was stricken from the bill that was ultimately enacted.[25] The Committee Report on the Senate version of the 1970 amendments stated that the language of the bill would not preclude bank holding companies

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[25] See 115 Cong. Rec. 33133, 33139 (1969). The House supporters of this prohibition acknowledged that, absent such a prohibition, banking organizations might well have been authorized to operate even *open-end* investment companies (mutual funds). 115 Cong. Rec. 32897, 32902-32903, 33135-33136 (1969).

from operating either open-end or closed-end investment companies if such activities were consistent with the Glass-Steagall Act. S. Rep. No. 91-1084, 91st Cong., 2d Sess. 15 (1970). And in agreeing on the language that was ultimately enacted, the Conference Committee expressly recognized that the Glass-Steagall Act would continue to serve as the touchstone in determining the range of permissible bank holding company securities activities. Section 4(c)(8) was intended neither to "enlarge" nor "contract" that range.[26]

In sum, the Board's regulation and interpretive ruling limit bank holding companies to those services that are fiduciary in nature, and accordingly the

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[26] The chairman of the Conference Committee stressed this point as follows (116 Cong. Rec. 42430 (1970) (emphasis supplied)):

> Mr. WILLIAMS of New Jersey. * * * I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may nevertheless be engaged in by bank-holding companies or their nonbanking affiliates.
>
> Mr. SPARKMAN. The answer to the Senator's question is that there clearly was not. As it now stands, the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business. *There are some specific exceptions, of course, but I can assure you that we did not mean to enlarge or contract them here.* We regarded that general prohibition as being so clearly applicable to the subjects of this bill as to make a restatement of it unnecessary. * * * In short, *we did not intend to amend or modify, directly or indirectly, any limitations on the activities of banks, bank-holding companies or any of their affiliates, now contained in the Glass-Steagall Act.*

standards of the Glass-Steagall Act are not infringed. The conclusion of the court of appeals (App. A, *infra*, 39a) that Section 4(c)(8) does not "cut back" on the Glass-Steagall Act is thus irrelevant to the question presented here. The Board's regulation gives full faith and credit both to the Bank Holding Company Act and to the Glass-Steagall Act by authorizing only those activities that are functionally analogous to the activities of bank trust departments and by segregating those activities from the process of issuing or underwriting securities.

4. Because the Board's regulation and interpretive ruling are supported by the plain meaning of the statute, as well as by its legislative history, and because Congress intended the Board to exercise its expert discretion in drawing the lines that it did, the court of appeals should have deferred to the Board's reasonable interpretation. See *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248, 251 (1978) ("courts should defer to an agency's construction of its own statutory mandate"); *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 369 (1973) ("the validity of a regulation * * * will be sustained so long as it is 'reasonably related to the purposes of the enabling legislation' "); *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 450 (1947) (Rutledge and Frankfurter, JJ., concurring) ("Not only because Congress has committed the system's operation to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all its phases, I think their judgment

should be conclusive upon any matter which, like this one, is open to reasonable difference of opinion"); see also *Investment Co. Institute* v. *Camp*, *supra*, 401 U.S. at 626-627.

The court of appeals erred in disregarding these principles of statutory construction and in striking down the Board's regulation and interpretive ruling.[27]

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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DECEMBER 1979

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[27] Because the court of appeals has invalidated the Board's regulation and interpretive ruling on a nation-wide basis, there will be no opportunity to obtain the views of another circuit on the validity of these provisions.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 77-1862

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

Petition for Review of an Order of the Board of Governors of the Federal Reserve System

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Argued October 18, 1978

Decided March 30, 1979

Before McGOWAN and WILKEY, *Circuit Judges*, and GASCH,* *United States District Judge* for the District of Columbia.

Opinion for the court filed by *Circuit Judge* McGOWAN.

McGOWAN, *Circuit Judge*: This direct review proceeding raises the question of whether federal bank-

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* Sitting by designation pursuant to 28 U.S.C. § 292(a).

ing legislation prohibits bank holding companies or their non-bank subsidiaries from acting as investment advisers to closed-end investment companies. Respondent Board of Governors of the Federal Reserve System (the Board) promulgated a regulation and accompanying interpretive ruling purporting to authorize such activity. Petitioner, a national association of mutual funds,[1] charged, both in the administrative proceedings and before this court, that the Board's action is (1) inconsistent with sections 16 and 21 of the Banking Act of 1933, 12 U.S.C. §§ 24 (Seventh), 378 (Glass-Steagall Act);[2] and (2) unauthorized by section 4(c)(8) of the Bank Holding Company Act of 1956.[3]

While we disagree with petitioner's argument as to the effect of the Glass-Steagall Act, our independent review of federal banking legislation convinces us that petitioner is entitled to relief under the Bank Holding Company Act. Because the statutory considerations that we have identified are somewhat different from those articulated by petitioner during the administrative proceedings, the Board was not

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[1] In a memorandum to the Board submitted September 23, 1971, petitioner described itself as "an association of 356 open-end investment companies, their 159 investment advisers, and 120 principal underwriters. These members, which include both "load" and "no load" funds, represent about 93 percent of the assets of all such companies in the United States." Joint Appendix (JA) at A-4 n.*.

[2] The Glass-Steagall Act is codified at various places in Title 12 of the United States Code.

[3] 12 U.S.C. §§ 1841 *et seq.*

pressed in those proceedings to develop at any length its views on these questions. However, although we normally pay considerable deference to the Board's interpretation of its organic statutes, *Board of Governors* v. *First Lincolnwood Corp.*, 99 S.Ct. 505, 513 (1978), we think it unnecessary in the present case to remand to the Board for further evaluation of the considerations we have here identified. For we find that the statutory materials—which are as accessible to this court as they are to the Board—compel the result we reach herein; and we vacate the regulation and interpretive ruling under review.

I

Section 4(a) of the Bank Holding Company Act, 12 U.S.C. § 1843(a), generally prohibits bank holding companies, *i.e.*, companies that own or control one or more commercial banks,[4] from engaging in nonbanking activities either directly or through a subsidiary company. However, section 4(c)(8) of the Act, 12 U.S.C. § 1843(c)(8), exempts from this prohibition subsidiaries whose activities are "so closely related to banking or managing or controlling banks as to be a proper incident thereto."[5] Bank holding

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[4] *See* § 2(a) of the Act, *as amended*, 12 U.S.C. § 1841(a).

[5] Section 4(c)(8), *as amended*, provides that § 4's prohibitions shall not apply to

> shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a

companies are permitted to engage directly in activities authorized for subsidiaries by section 4(c)(8) by virtue of section 4(a)(2)(B) of the Act, 12 U.S.C. § 1843(a)(2)(B). The Board, acting pursuant to authority delegated in section 4(c)(8), has heretofore identified a number of activities as "closely related to banking," and therefore permitted to bank holding companies and their non-bank subsidiaries, in its Regulation Y, 12 C.F.R. § 225.4.

On August 12, 1971, the Board issued notice of a proposed amendment to Regulation Y [6] authorizing bank holding companies and their non-bank subsidiaries to serve as investment advisers to any investment company registered under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.* An investment company is a corporation or trust whose business is the investment and reinvestment of the pool of funds contributed by its shareholders. *See*

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proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern. . . .

[6] 36 Fed. Reg. 16,695 (1971), corrected, 36 Fed. Reg. 17,514 (1971).

section 3(a) of the Investment Company Act, 15 U.S.C. § 80a-3(a). An investment adviser is a company that, in addition to rendering investment advice, typically organizes, manages and controls an affiliated investment company.[7]

The Board received numerous written comments on its proposal and, at the request of petitioner herein, held a public hearing in which petitioner and other parties presented further views. On January 28, 1972, the Board adopted the proposed regulation with certain minor clarifications. 12 C.F.R. § 225.4 (a)(5)(ii), 37 Fed. Reg. 1463 (1972). As amended, the regulation provides in pertinent part:

> (a) *Activities closely related to banking or managing or controlling banks.* . . . The following activities have been determined by the Board

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[7] One authority has characterized the investment company industry as follows:

> Although a few mutual funds are managed along conventional corporate lines by their own officers and directors, most of them are formed, promoted, and managed by external organizations that are separately owned and operated. These separate organizations are usually designated as "investment advisers." The advisers select the funds' investments and operate or supervise most other aspects of their business. In return for their services they receive an advisory fee. The fee is almost always a percentage of the value of the fund's net assets fluctuating upward or downward as the value of the portfolio changes.

Securities and Exchange Comm'n, *Public Policy Implications of Investment Company Growth*, H.R. REP. No. 2337, 89th Cong., 2d Sess. 8-9 (1966) (footnote deleted). *Accord*, S. REP. No. 184, 91st Cong., 1st Sess. 5 (1969).

> to be so closely related to banking or managing or controlling banks as to be a proper incident thereto:
>
> . . . .
>
> (5) . . . (ii) serving as investment adviser, as defined in section 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act . . . .

The Board apparently intended, when it proposed this regulation, that it would apply equally to the two main varieties of investment companies, closed-end and open-end.[8] An open-end company (also commonly called a "mutual fund") is continuously engaged in issuing its shares and stands ready at any time to redeem them; a closed-end company typically does not issue shares after its initial offering except at infrequent intervals, and does not stand ready to redeem them. 12 C.F.R. § 225.125(c), 37 Fed. Reg. 1464 (1972).[9] During the course of the administrative proceedings, however, several participants, in-

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[8] Both of these are considered "management companies" under section 4 of the Investment Company Act, 15 U.S.C. § 80a-4. That section recognizes two other types of investment companies, "face amount certificate companies" and "unit investment trusts". *Id.* These are infrequently encountered and are not relevant to the instant case.

[9] *Compare* § 5(a)(1) of the Investment Company Act, 15 U.S.C. § 80a-5(a)(1) *with* § 5(a)(2) of the Act, 15 U.S.C. § 80a-5(a)(2). Shares in an open-end company are continuously bought from and sold to the company itself, while shares in a closed-end company, after the initial issuance, are typically bought and sold on the open market.

cluding petitioner herein [10] and the Department of Justice,[11] objected to permitting bank holding companies or their subsidiaries to advise *open-end* investment companies.

In response to these comments, the Board supplemented its regulation with a simultaneously issued interpretive ruling. 12 C.F.R. § 225.125, 37 Fed. Reg. 1464 (1972). The Board concluded that the provisions of the Glass-Steagall Act, particularly as interpreted by the Supreme Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971),[12] prohibited bank holding companies from sponsoring, organizing, or controlling (hereinafter, "operating") *open-end* investment companies. 12 C.F.R. § 225.125

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[10] JA at A-4, A-26.

[11] Record at 86-97. The Department of Justice lauded the "pro-competitive" aspects of the proposal, but warned the Board that the limitations imposed by § 20 of the Glass-Steagall Act, 12 U.S.C. § 377, might prohibit bank holding companies from offering adviser services to mutual funds.

[12] The *Camp* case held that sections 16 and 21 of the Glass-Steagall Act prohibited a national bank from selling interests in a "commingled investment account"—the functional equivalent of an open-end investment company. The fund at issue in *Camp* was apparently not set up as a separate corporation from the bank itself. Petitioner argued to the Board that, because of the dominance usually exerted over the fund by the adviser, *see* note 7 and accompanying text, *supra*, the reasoning of the *Camp* case was equally applicable in the more common situation in which the fund and its adviser were separate corporate entities. The Board implicitly accepted this argument. 12 C.F.R. §§ 225.125(e), (f).

(f).[13] Because of their lower level of securities activity, however, *see* note 9 and accompanying text *supra*, the Board found that *closed-end* investment companies are not subject to these prohibitions "so long as [they] are not primarily or frequently engaged in the issuance, sale, and distribution of securities." 12 C.F.R. § 225.125(f).

The interpretive ruling imposed a number of other restrictions on investment advisory activities by bank holding companies. These limitations were designed, generally, to prevent association in the public mind of the investment company and the bank holding company, *see* 12 C.F.R. §§ 225.125(f), .125(h); to forbid the bank holding company's subsidiary bank from extending credit to the investment company, purchasing, selling or distributing its shares, or accepting its securities as collateral for a loan to purchase other of its securities, *see* 12 C.F.R. §§ 225.125(g), .125(h); and to prohibit unfair sales practices di-

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[13] The Board found, however, that bank holding companies could act as investment advisers to mutual funds so long as they did not sponsor, organize or control them. *See* 12 C.F.R. §§ 225.125(d), (e), (f). This would appear tantamount to a finding that bank holding companies may at least render *advice* to an affiliated mutual fund. Petitioner challenged even this limited authorization before the Board, *see* JA at A-13-16, but has not renewed that argument on judicial review, apparently because its objections were satisfied by certain additional safeguards provided by the Board in its interpretive ruling, *see* note 14 and accompanying text *infra*.

rected towards customers of the bank subsidiary, *see* 12 C.F.R. § 225.125(h).[14]

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[14] The relevant portions of the intrepretive ruling are as follows:

> (f) In the Board's opinion, the Glass-Steagall Act provisions, as interpreted by the U.S. Supreme Court, forbid a bank holding company to sponsor, organize or control a mutual fund. However, the Board does not believe that such restrictions apply to closed-end investment companies as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities. In no case, however, should a bank holding company act as investment adviser to an investment company which has a name that is similar to, or a variation of, the name of the holding company or any of its subsidiary banks.
>
> (g) In view of the potential conflicts of interests that may exist, a bank holding company and its bank and nonbank subsidiaries should not (1) purchase for their own account securities of any investment company for which the bank holding company acts as investment adviser; (2) purchase in their sole discretion, any such securities in a fiduciary capacity (including as managing agent); (3) extend credit to any such investment company; or (4) accept the securities of any such investment company as collateral for a loan which is for the purpose of purchasing securities of the investment company.
>
> (h) A bank holding company should not engage, directly, [*sic*] in the sale or distribution of securities of any investment company for which it acts as investment adviser. Prospectuses or sales literature should not be distributed by the holding company, nor should any such literature be made available to the public at any offices of the holding company. In addition, officers and employees of bank subsidiaries should be instructed not to express any opinion with respect to advisability of purchase of securities of any investment company for which the bank holding company acts as investment adviser. Customers of banks in a bank holding company system who request information on an unsolicited basis regard-

After an initial jurisdictional misstep,[15] petitioner brought this challenge to an order of the Board re-

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ing any investment company for which the bank holding company acts as investment adviser may be furnished the name and address of the fund and its underwriter or distributing company, but the names of bank customers should not be furnished by the bank holding company to the fund or its distributor. Further, a bank holding company should not act as investment adviser to a mutual fund which has offices in any building which is likely to be identified in the public's mind with the bank holding company.

(i) Acting in such capacities as registrar, transfer agent, or custodian for an investment company is not a selling activity and is permitted under § 225.4(a)(4) of Regulation Y. However, in view of potential conflicts of interests, a bank holding company which acts both as custodian and investment adviser for an investment company should exercise care to maintain at a minimal level demand deposit accounts of the investment company which are placed with a bank affiliate and should not invest cash funds of the investment company in time deposit accounts (including certificates of deposit) of any bank affiliate.

[15] Petitioner, after the Board denied its petition for reconsideration and rescission, originally brought suit in the District Court requesting an injunction and a declaratory judgment that the challenged action was unlawful. The District Court dismissed the complaint on the ground that the sole forum for judicial review was the Court of Appeals. Investment Co. Inst. v. Board of Governors, 398 F. Supp. 725 (D.D.C. 1975). This court upheld the District Court's ruling. Investment Co. Inst. v. Board of Governors, 551 F.2d 1270 (D.C. Cir. 1977). Petitioner thereupon filed a second petition for reconsideration and rescission which the Board once again denied. Order Rejecting Petition of Investment Company Institute for Reconsideration and Recision [*sic*] of a Regulation by the Board, 12 C.F.R. § 225.4(a)(5)(ii), effective August 31, 1977, JA at A-169. It is this order that is under review in the present proceeding.

jecting its petition for reconsideration and rescission of 12 C.F.R. § 225.4(a)(5)(ii).[16] The case presents a variation on a recurring theme in modern banking law: the tension between federal regulatory statutes designed in part to limit bank activities, and attempts by banks—often sanctioned by federal banking authorities—to compete in broader lines of business.[17] To

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[16] The case has been the subject of considerable scholarly interest. *See, e.g.*, R. JENNINGS & H. MARSH, SECURITIES REGULATION 1351-52 (4th ed. 1977); J. WHITE, BANKING LAW 375-82 (1976).

[17] Aided by a series of liberal interpretations by the Comptroller of the Currency, national banks sought in the 1960's to expand the range of their activities in-house. These efforts, however, were largely undone by various court rulings restrictively interpreting the powers of national banks under the National Bank Act. *See, e.g.*, Investment Co. Inst. v. Camp, 401 U.S. 617 (1971); First Nat'l Bank v. Dickinson, 396 U.S. 122 (1969); Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972); National Retailers Corp. v. Valley Nat'l Bank, 411 F. Supp. 308 (D. Ariz. 1976); Georgia Ass'n of Indep. Ins. Agents, Inc. v. Saxon, 268 F. Supp. 236 (N.D. Ga. 1967), *aff'd*, 399 F.2d 1010 (5th Cir. 1968); Baker, Watts & Co. v. Saxon, 261 F. Supp. 247 (D.D.C. 1966), *aff'd sub nom.* Port of New York Auth. v. Baker, Watts & Co., 392 F.2d 497 (D.C. Cir. 1968). *But see* M & M Leasing Corp. v. Seattle First Nat'l Bank, 563 F.2d 1377 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978). Banks have more recently turned to the holding company device, seeking to expand by means of non-bank subsidiaries of the holding company into new fields such as insurance, Alabama Ass'n of Ins. Agents v. Board of Governors, 533 F.2d 224 (5th Cir. 1976), *modified on other grounds*, 558 F.2d 729 (5th Cir. 1977), *cert. denied*, 435 U.S. 904 (1978), courier services, National Courier Ass'n v. Board of Governors, 516 F.2d 1229 (D.C. Cir. 1975), or travel agencies, Association of Bank Travel Bureaus, Inc. v. Board of Governors, 568 F.2d 549 (7th Cir. 1978). *See* J. White, *supra* note 16, at 299.

our knowledge, it is the first case in which a court has been asked to determine the permissibility of activities in the *securities* area by bank holding companies and their non-bank subsidiaries.

II

Respondent argues, as a threshold matter, that petitioner lacks standing to bring this suit. In the field of banking legislation, however, Congress has evidenced its concern to give broad rights of judicial review to parties alleging competitive injury as a result of decisions by federal banking authorities. Thus, the Supreme Court has found standing in parties challenging regulations by the Comptroller of the Currency authorizing national banks to enter into competitive lines of business. *Investment Company Institute* v. *Camp*, 401 U.S. 617, 620-21 (1971); *Association of Data Processing Service Organizations, Inc.* v. *Camp*, 397 U.S. 150, 152-56 (1970).

The same congressional concern to grant rights of judicial review to competitors is present when challenge is made to a decision of the Federal Reserve's Board of Governors. Section 9 of the Bank Holding Company Act provides that "[a]ny party aggrieved by an order of the Board" is entitled to judicial review thereof. 12 U.S.C. § 1848. Congress unambiguously demonstrated its intent that standing be liberally granted in a 1970 amendment to the Act that further defined the class of parties aggrieved to include those who would become competitors as a

result of a bank holding company's entering a nonbanking business pursuant to order of the Board. 12 U.S.C. § 1850. As noted in the Conference Committee Report to the 1970 Amendments, the purpose of this provision is to guarantee a "properly liberal attitude concerning the right of competitors of banks and bank holding companies to have standing" such that "the broadest possible forum [is] allowed for adversary proceedings to take place in order that all issues may be aired completely." H.R. REP. No. 1747, 91st Cong., 2d Sess. 29, 30 (1970) [hereinafter cited as 1970 CONF. REP.].

We have no doubt that, in the context of such strongly expressed congressional intent, the irreducible constitutional minima in the standing doctrine are satisfied in this case. It is settled that an organization has standing to sue on behalf of its injured members. *Warth* v. *Seldin*, 422 U.S. 490, 511 (1975); *Sierra Club* v. *Morton*, 405 U.S. 727, 734-41 (1972). Petitioner alleged before the District Court, in an earlier stage of this controversy, *see* note 15 *supra*, that the Board's regulation

> will subject the Institute's investment company members to illegal competition, will deprive them of legitimate business, and will dilute, divert and withdraw a substantial portion of the potential market for securities of investment companies to the substantial and irreparable injury of such members of the Institute and their shareholders. . . .

JA at A-78. Moreover, the injuries alleged are not merely "speculative," *see Simon* v. *Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26, 42 (1976). Petitioner alleges that, as a result of § 225.4(a)(5)(ii), many bank holding companies or their subsidiaries are actively engaged in the operation of closed-end investment companies to the detriment of its members. We conclude, then, that petitioner has standing to bring this action.

III

A.

Petitioner first argues that the Board's order and interpretive ruling authorize conduct in violation of section 21 of the Glass-Steagall Act, *as amended*, 12 U.S.C. § 378. Section 21 provides, in pertinent part, that it is unlawful

> For any person, firm, corporation association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor. . . .

Petitioner bases its argument largely on *Investment Company Institute* v. *Camp*, *supra*. It contends that

although *Camp* involved a *national bank's* operation of an *open-end* company, that case's analysis of section 21 is equally applicable to a *bank holding company's* operation of a *closed-end* company.

The Board, for its part, counters with two somewhat inconsistent contentions. First, it observes that while open-end companies are continuously buying and selling their shares, closed-end companies typically issue their shares only in their initial offering and at infrequent intervals thereafter. It notes that even closed-end companies are not within the regulation if they are "primarily or frequently" engaged in the issuance, sale and distribution of securities, 12 C.F.R. § 225.125(f), and notes further that the interpretive ruling prohibits a bank holding company from any involvement in the public sale or distribution of the securities. 12 C.F.R. § 225.125(h). Stated in statutory terms, the Board's first argument is that an investment adviser may, under the limitations contained in its interpretive ruling, operate a closed-end company without engaging in the "*business* of issuing, underwriting, selling, or distributing" the securities of that company. Although the Board's argument in this regard appears at least superficially plausible, we need not decide here whether the weight it gives the distinction between closed- and open-end companies is rationally based in the evidence of record, or whether its interpretation of section 21 of the Act, as applied to these facts, is sustainable in light of the deference owed to the Board's construction of

federal banking statutes. For we find a clearer ground of decision in the Board's second argument.

This second argument is based both on the literal language of section 21 and on the structure of the Glass-Steagall Act as a whole. Section 21 in terms applies only to entities that are "engaged in the [securities] business" *and* "engaged at the same time to any extent whatever" in the commercial banking business. The Board contends that, even if a closed-end fund's investment adviser is engaged in the securities business, it is not subject to section 21 because it performs no commercial banking functions.[18]

Petitioner's response is that other subsidiaries of the bank holding company *are* engaged in commercial banking, and that in view of the Glass-Steagall Act's "prophylactic" goal, *ICI* v. *Camp*, *supra*, 401 U.S. at 639, of separating investment from commercial banking, all elements in the bank holding company structure should be considered a "single entity" for pur-

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[18] This argument would appear somewhat inconsistent with the previous one, and with the Board's interpretive ruling, because if the argument is accepted the Board would have no need to distinguish closed- and open-end companies. That is, if bank holding companies are not "engaged in" commercial banking, then it would be perfectly permissible, under section 21, for a bank holding company to operate an open-end investment company—activity that the Board has concluded would violate the Glass-Steagall Act. We do not think, however, that the Board's interpretive ruling is irrational because of this fact. Given the vagaries of judicial review, the Board was entitled to shape its action to insure against judicial reversal even if in doing so it adopted somewhat inconsistent positions.

poses of section 21. Stated another way, petitioner's argument is that the holding company and all of its subsidiaries fall within the terms of "any person, firm, corporation, association, business trust, or other similar organization" subject to section 21.

While we agree that the purposes of the Glass-Steagall Act are fully broad enough to encompass the activities of bank holding companies and their non-bank subsidiaries, *see* text accompanying note 31 *infra*, these broad purposes fail to advance petitioner's argument. The list of entities subject to section 21 conspicuously omits reference to distinct corporations related by ownership interests, and it is unlikely that Congress intended the inclusive phrase "other *similar* organization" to extend this far.

This inference is powerfully supported by the structure of the Glass-Steagall Act, which as originally enacted divided bank-related activities into three categories. First, Congress prohibited any organization from engaging *in-house* in both commercial banking and securities activities. In this category fell section 21, which was designed to prohibit the great investment banking houses from engaging in deposit banking.[19] Second, Congress sought to divorce

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[19] That Section 21 was intended to apply to in-house activities only is clear from the following colloquy between Senator Glass, co-sponsor of the bill, and Senator Robinson:

> Sen. Glass: . . . Here we prohibit the large private banks, whose chief business is investment business, from receiving deposits. We separate them from the deposit banking business.
>
> . . . .

[Footnote continued on page 18a]

commercial banks from affiliated securities firms. Ownership or control of securities affiliates was forbidden to national banks and state banks that were members of the Federal Reserve System (state member banks) by section 20 of the Act, 48 Stat. 188, *codified as amended*, 12 U.S.C. § 377.[20] Interlocking

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[19] [Continued]

Sen. Robinson: *That means if they wish to receive deposits they must have separate institutions for that purpose?*

Sen. Glass: *Yes.*

77 Cong. Rec. 3730 (1933) (emphasis supplied). *See also id.* at 4180 (Remarks of Sen. Bulkley).

Also falling in this category is § 16 of the Act, *set forth* at text accompanying note 23 *infra*. Section 16 was designed to deal with the converse situation from § 21: while § 21 prohibited investment banks from engaging in commercial banking, § 16 prohibited commercial banks subject to the Act from carrying on securities activities.

[20] As enacted, § 20 provided in pertinent part that

> no member bank shall be affiliated in any manner described in section 2(b) hereof with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities.

Section 2(b) of the Act, 48 Stat. 162, *codified* at 12 U.S.C. § 221a, defined "affiliate" to

> include any corporation, business trust, association, or other similar organization—
>
> (1) Of which a memebr bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding

managements between national or state member banks and securities firms were forbidden by section 32 of the Act, 48 Stat. 194, *codified as amended*, 12 U.S.C. § 78 (1976).[21] Third, Congress sought to divorce as far as possible bank holding companies from their subsidiaries which carried on securities activities. These securities subsidiaries were forbidden, under section 19(e) of the Act, 48 Stat. 188, *repealed in pertinent part*, 80 Stat. 242-43, to any bank holding

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election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; or

(2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preceding election, or by trustees for the benefit of the shareholders of any such bank; or

(3) of which a majority of its directors, trustees, or other persons exercising similar function are directors of any one member bank.

[21] As enacted, § 32 provided in pertinent part that

no officer or director of any member bank shall be an officer, director, or manager of any corporation, partnership, or unincorporated association engaged primarily in the business of purchasing, selling, or negotiating securities . . . .

48 Stat. 194.

The coverage of § 20 and § 32 was, and is, not perfectly congruent; while § 20 applies to affiliates "engaged principally" in the investment business, the coverage of § 32 is somewhat broader and extends to entities "engaged primarily" in securities dealings. Board of Governors v. Agnew, 329 U.S. 441, 448 (1947).

company that wished to vote its shares of a national or state member bank.[22]

This tripartite structure, in our view, is convincing evidence that Congress rejected a "single entity" theory in favor of a more discriminating approach to the problem. *See also Board of Governors* v. *Agnew*, 329 U.S. 441, 448 (1947). Congress, in the Glass-Steagall Act, did indeed intend to regulate the activities of

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[22] Section 19(e) provided that holding company affiliates could not vote their shares unless they agreed not to own, control, or have any interest in a "securities company," defined as

> any corporation, business trust, association or other similar organization formed for the purpose of, or engaged principally in, the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities of any sort. . . .

48 Stat. 188. This provision was made applicable to state member banks by § 5 of the Act, 48 Stat. 166, *repealed*, 80 Stat. 243.

"Holding company affiliate" was defined to include

> any corporation, business trust, association, or other similar organization—
>
> (1) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of any one bank at the preceeding election, or controls in any manner the election of a majority of the directors of any one bank; or
>
> (2) For the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees.

Section 2(c) of the Act, 48 Stat. 163, *repealed*, 80 Stat. 242. *Compare* the definition of "affiliate" in note 20 *supra*.

bank holding companies and their non-bank subsidiaries—but *not* in section 21 of the Act. Because we conclude that section 21 was intended to apply to in-house activities only, we find that it is not violated by the Board's regulation and interpretive ruling challenged herein.

B.

Petitioner challenges the Board's action, alternatively, as being inconsistent with section 16 of the Glass-Steagall Act, *as amended*, 12 U.S.C. § 24 (Seventh). Section 16 provides in pertinent part that

> The business of dealing in securities and stock by [a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and [a national bank] shall not underwrite any issue of securities or stock. . . . Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by [a national bank] for its own account of any shares of stock of any corporation.[23]

As to this section, petitioner concedes that only the activities of banks, and not those of other entities within the holding company structure, are within its terms. It argues, however, that national and state member banks are authorized to act as investment ad-

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[23] These limitations are made applicable to state member banks by § 5(c) of the Glass-Steagall Act, 12 U.S.C. § 335.

visers by the following statement in the Board's interpretive ruling:

> Under § 225.5(a)(5) [*sic*], as amended, bank holding companies (*which term, as used herein, includes both their bank and nonbank subsidiaries*) may, in accordance with the provisions of § 225.4(b), act as investment advisers to various types of investment companies. . . .

12 C.F.R. § 225.125(c) (emphasis added). Such activity by national and state member banks, in petitioner's view, is directly forbidden by section 16.[24]

The Board, however, disclaims any intention of authorizing banks, as opposed to bank holding companies and their non-bank subsidiaries, to act as investment advisers. It notes that its interpretive ruling was issued pursuant to section 4(c)(8) of the Bank Holding Company Act, which authorizes activity only by bank holding companies themselves[25] or their non-bank subsidiaries. Therefore, says the Board, it did not and could not permit *banks* to engage in investment adviser activities. The reference to bank subsidiaries in the interpretive ruling, according to the Board, was designed to impose only the *restrictions* of that ruling, *see* note 14 and accompanying text *supra*, on subsidiary banks.[26]

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[24] Petitioner claims that, in reliance on this ruling, numerous national and state member banks are now acting as investment advisers to closed-end investment companies.

[25] *See* § 4(a)(2)(B) of the Bank Holding Company Act, 12 U.S.C. § 1843(a)(2)(B).

[26] The Board disputes petitioner's claim that banks have initiated investment adviser services in reliance on the Board's

Although the Board's explanation of the interpretive ruling is reasonble, it is nevertheless true that the ruling is highly susceptible to the construction urged by petitioner. While that ruling has been published in the Federal Register and the Code of Federal Regulations, the Board's disclaimer has, so far as we know, been circulated only to petitioner, JA at A-68, and to other persons who may have had occasion to read that letter or the Board's brief in this review proceeding. The publication of this opinion should serve to bring to wider public attention the Board's interpretation of the reference to bank subsidiaries in 12 C.F.R. § 225.125(c).

IV

This is, however, not the end of our inquiry. The operative phrase we are called upon to interpret is not found in the Glass-Steagall Act but rather in the Bank Holding Company Act, as amended; the precise issue before us is whether operating a closed-end investment company, under the terms of the Board's regulation and interpretive ruling, is "so closely related to banking or managing or controlling banks as to be a proper incident thereto." Section 4(c)(8)

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action, *see* note 24 *supra*. It notes that *if* banks had actually initiated such services in reliance on Regulation Y, they would have had to apply to the Board for specific approval prior to offering the service. *See, e.g.*, National Courier Ass'n v. Board of Governors, 516 F.2d 1229 (D.C. Cir. 1975). According to the Board, it has not received a single application for permission for a bank to engage in investment adviser services.

of the Bank Holding Company Act, *as amended*, 12 U.S.C. § 1843(c)(8). The Glass-Steagall Act is not dispositive of this question, for even if it is not violated directly, it remains possible that the Bank Holding Company Act has been contravened. At the same time, of course, the Glass-Steagall Act is not irrelevant to this inquiry; its policies may well carry forward and inform the meaning of the later statute.

We are bound to note that the Board was never forcefully presented with this argument. Petitioner did allege before the Board and at oral argument before us that the Board had authorized conduct in violation of section 4(c)(8). However, on analysis this argument can be seen to collapse for the most part into petitioner's basic contention that the Board has no authority to authorize conduct in violation of sections 16 and 21 of the Glass-Steagall Act. The Board's construction of the Bank Holding Company Act in relation to the issue before us would ordinarily be entitled to a high degree of deference, *Board of Governors* v. *First Lincolnwood Corp.*, 99 S.Ct. 505, 513 (1978); *cf. ICI* v. *Camp, supra*, 401 U.S. at 626-27 (Comptroller of the Currency). We cannot, however, abdicate our duty in the final instance to say what the law is, *International Brotherhood of Teamsters* v. *Daniel*, 99 S.Ct. 790, 800 & n.20 (1979); *SEC* v. *Sloan*, 436 U.S. 103, 118-19 (1978). And our conclusion, based on the legislative histories of the present section 4(c)(8) and its predecessor statutes, is emphatically that section 4(c)(8) does not empower the Board to authorize conduct of the type

at issue here. In light of this conclusion, we find that the appropriate disposition is to vacate the Board's regulation and interpretive ruling rather than to remand to the agency for what would be an expensive, time-consuming, and ultimately pointless reconsideration.

A.

There have been three main episodes in the rather complex history of federal legislation aimed at regulating bank holding companies: the Glass-Steagall Act, in 1933; the Bank Holding Company Act, in 1956 (1956 Act); and the Bank Holding Company Act Amendments, in 1970 (1970 Amendments). Of course, the determinative consideration is the meaning to be attributed to section 4(c)(8) in the most recent statute. As will be seen, however, it is necessary to examine the earlier provisions in order to divine what Congress intended in 1970.

As we have noted, *see* note 22 and accompanying text *supra*, Congress addressed the problem of securities activities by bank holding companies in section 19(e) of the Glass-Steagall Act. Congress' approach to this problem differed somewhat from its treatment of securities activities by banks themselves or by their non-holding company affiliates. While in the latter situations Congress simply proscribed the activities in question, *see* notes 19-21 and accompanying texts *supra*, in the case of holding company affiliates Congress permitted the affiliation to continue, but only so long as the holding company did not vote its shares in its subsidiary bank.

This somewhat less restrictive treatment of bank holding companies did not stem from any congressional perception that the securities activities of bank holding companies or their non-bank affiliates were any less insidious than those of banks themselves or of firms with which banks were affiliated directly rather than through a holding company parent. Although the Senate hearings [27] that culminated in the Glass-Steagall Act focused primarily on the latter, direct type of securities affiliate, it is clear that the hazards identified at those hearings of affiliation between banks and securities firms were present [in] the case of holding company affiliates also.[28] As the Senate Re-

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[27] *Hearings Pursuant to S. Res. 71 before a Subcommittee of the Senate Committee on Banking and Currency*, 71st Cong., 3d Sess. (1931) [hereinafter cited as *1931 Hearings*].

[28] The hearings identified numerous abuses and unsound practices associated with bank securities activities. *See generally ICI* v. *Camp*, *supra*, 401 U.S. at 629-634. The evidence before the subcommittee showed that securities affiliates were involved in a wide variety of activities, including underwriting, wholesaling and retailing securities, holding assets for the benefit of the affiliated bank, buying and selling securities purely for speculative purposes, trading in the bank's own stock in order to "support[] the market," and holding real estate assets. *1931 Hearings*, *supra* note 27, at 1057. There was a danger that banks affiliated with such securities firms would make imprudent use of their own or their depositors' assets, either through direct investment in the securities affiliate or its portfolio or through making unsound loans to it. There was the possibility that a bank's promotional interest in its securities affiliate might cause it to lend its reputation for financial prudence to the affiliate, *see id.* at 1063; *ICI* v. *Camp*, *supra*, 401 U.S. at 631; might distort the bank's credit policies, *see 1931 Hearings*, *supra* note 27, at 87, 1064; *see*

port on the bill that became the Glass-Steagall Act noted, "[t]he evils of indirect control are similar in the two cases, and they may lead to similar abuses, as is seen when it is noted that holding companies also usually control companies organized for security financing." 1933 S. REP., *supra* note 28, at 10. The different treatment for holding company affiliates stemmed solely from a congressional concern that, under the commerce clause as then restrictively interpreted, Congress did not have power to force a state-

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also S. REP. NO. 77, 73d Cong., 1st Sess. 9-10 (1933) [hereinafter cited as 1933 S. REP.]; and might cause the bank to disregard its fiduciary duty to its shareholders, *see 1931 Hearings, supra* note 27, at 266, 1064; *see also* 75 CONG. REC. 9912 (1933) (remarks of Sen. Bulkley). Further, it was felt that the relation between bank and affiliate mutually reinforced unduly risky investment policies: the banks knew that their unwise investments could be shifted to the affiliate while the affiliates knew that in case of need they had a ready source of funds in the bank. *1931 Hearings, supra* note 27, at 1064. There was also the danger that poor performance of the securities affiliate would cause a loss of public confidence in the bank, *id.* at 1063-64; *see* 77 CONG. REC. 3835 (1933) (remarks of Rep. Steagall). In the words of Senator Glass, 75 CONG. REC. 9887 (1933),

> The committee ascertained . . . that one of the greatest contributions to the unprecedented disaster which has caused this almost incurable depression was made by these bank affiliates. They sent out their high-pressure salesmen and literally filled the bank portfolios of this country with these investment securities. They actually dealt in the stocks of the parent bank. . . . They were organized to evade the law.

chartered bank holding company to divest itself of a state-chartered securities affiliate.[29]

Section 19(e) of the Glass-Steagall Act applied only to entities "formed for the purpose of, or engaged principally in" the securities business. *See* note 22 *supra*. It is now too late to know whether this language would have encompassed a bank holding company's operation of a closed-end investment company under the limitations of the Board's interpretive ruling.[30] What is important for our purposes, however, is not what the specific language in the Glass-Steagal Act would have meant, but, rather, what subsequent Congresses *thought* that Act to have meant. And as to this question there is little doubt. The broad purpose of the Glass-Steagall Act, and most importantly the effect of the Act *as viewed by*

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[29] In the words of the Senate Committee:

> Since the companies are State corporations, Congress has no control over them, except that which may be voluntarily granted. However, since the staple of their ownership or holdings is the stock of National and State member banks, it would seem that Congress may control the conditions under which such stocks may be owned and particularly voted.

1933 S. REP., *supra* note 28, at 10.

[30] There is indirect evidence that at least the industry viewed the Glass-Steagall Act as broadly prohibiting such activity. *See* Securities & Exch. Comm'n, *Report to Congress on Investment Trusts and Investment Companies*, H.R. Doc. 70, 76th Cong., 1st Sess. 59 (1939) ("The most striking changes in the sponsorship of closed-end companies within the period 1929 and 1935 were the disappearance of national bank securities affiliates as sponsors because of the abolition of such affiliates by the [Glass-Steagall Act].").

later Congresses, was to divorce completely investment from commercial banking, to "separate as far as possible national and member banks from affiliates of all kinds." [31]

B.

The holding company provisions of the Glass-Steagall Act, including section 19(e), applied only if the subsidiary bank was a member of the Federal Reserve System and the holding company sought to exercise control by actually voting its shares. These limitations ultimately became a major loophole in the Act that permitted bank holding companies to acquire a wide variety of nonbanking subsidiaries.[32] Congress sought to rectify the situation in the Bank Holding Company Act by requiring holding companies (defined to include companies controlling nonmember banks) to divest themselves of their nonbanking businesses. Section 4(a) of the 1956 Act, *as amended,* 12 U.S.C. § 1843(a). However, the 1956 Act provided a series of specific exemptions from this requirement, including the predecessor of the one rele-

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[31] 1933 S. REP., *supra* note 28, at 10; *see also* 77 CONG. REC. 3835 (1933) (remarks of Rep. Steagall).

[32] See Board of Governors v. First Lincolnwood Corp., 99 S.Ct. 505, 511 (1978); H.R. REP. No. 609, 84th Cong., 1st Sess. 9 (1955) [hereinafter cited as 1955 H.R. REP.]

Although this loophole apparently would have permitted bank holding companies to acquire *securities* subsidiaries, Congress was unaware of any such acquisitions. This is further evidence that the financial community viewed the Glass-Steagall Act as having completely divorced the functions of commercial and investment banking.

vant here, section 4(c)(6) of the Act, 70 Stat. 137. In pertinent part, this provision exempted

> shares of any company all the activities of which are of a financial, fiduciary, or insurance nature and which the Board . . . has determined to be *so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto* and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act (emphasis added).

Although the legislative history provides virtually no guidance as to the meaning of this phrase,[33] it would appear that Congress did not intend the exemption to be so broad as to cover shares of an investment adviser operating a closed-end investment company. The 1956 Act, as we have noted, was a loophole-closing law designed to further the Glass-Steagall Act's overarching policy, *see* text accompanying note 31 *supra*, of divorcing investment from commercial banking.[34] There is no doubt that the Glass-Steagall Act was designed to separate banks from investment subsidiaries of their holding company affiliates. We

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[33] *See* National Courier Ass'n v. Board of Governors, 516 F.2d 1229, 1236 (D.C.Cir. 1975).

[34] *See* 1955 H.R. REP., *supra* note 32, at 16; S. REP. NO. 1095, 84th Cong., 1st Sess. 1, 2 (1955) [hereinafter cited as 1955 S. REP.]. *See also* S. REP. NO. 1179, 89th Cong., 2d Sess. 2 (1966) [hereinafter cited as 1966 S. REP.] (1956 Act was intended to apply "the general purposes of the Glass-Steagall Act of 1933—to prevent unduly extensive connections between banking and other businesses.").

cannot lightly infer that the 1956 Congress intended, *sub silentio*, to undermine what it perceived as a fundamental policy of a law that it was attempting to supplement and strengthen.

Such legislative history as exists supports the view that the Board's discretion in applying this exemption was to be a narrow one. Board Chairman William McChesney Martin reported to both the Senate and House Committees that the Board's authority to exempt shares of closely related businesses was to be "limited." [35] The examples given of activities that obviously fell within this exception were extremely narrow, and did not include any securities related activities.[36] Despite the narrowness of this discretion, the House Committee refused to report the provision.[37] When the House acceded to the Senate version con-

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[35] *See Control and Regulation of Bank Holding Companies: Hearings on H.R. 2674 Before the House Comm. on Banking and Currency*, 84th Cong., 1st Sess. 14 (1955); *Control of Bank Holding Companies: Hearings on S. 880, S. 2350, and H.R. 6227 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 84th Cong., 1st Sess. 76 (1955) [hereinafter cited at *1955 Senate Hearings*].

In another context of the same hearings, Chairman Martin said that "I would like to have [as] little discretionary authority as I can have." *1955 Senate Hearings, supra*, at 47.

[36] The Senate Committee reported that obviously exempt activities might include "operation of a credit life-insurance program in connection with bank loans" and "an insurance program under which the insurance proceeds retire the outstanding balance of the mortgage upon the death of the mortgagor in cases where the bank holds the mortgage." 1955 S. REP., *supra* note 32, at 13.

[37] 1955 H.R. REP., *supra* note 29, at 16.

taining the exemption, it was with the explicit assurance on the part of the Chairman of the House Committee that the Senate amendments did not make any "material change" [38] in the legislation as it passed the House. In light of this assurance, it is difficult to believe that the House felt that it was agreeing to a grant of discretion to the Board so sweeping as to cut back on the prohibitions of the Glass-Steagall Act.

Our conclusion that the 1956 Act was in all probability not intended to permit bank holding company operation of a closed-end investment company is supported by the subsequent repeal of section 19(e) of the Glass-Steagall Act, the provision that required holding companies wishing to vote their bank's shares to divest themselves of their securities subsidiaries.[39] The Senate Report, commenting on the repeal, noted that section 19(e) "*serve[d] no substantial purpose*" after passage of the 1956 Act.[40]

C.

The question then becomes whether the 1970 Amendments to the 1956 Act had the effect of enlarging the Board's authority to the degree contemplated by its regulation and interpretive ruling. The principal purpose of the 1970 Amendments was to prevent one-bank holding companies—which had been exempt

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[38] 102 CONG. REC. 7165 (1956) (remarks of Rep. Spence).

[39] Section 13(c) of the Bank Holding Company Act Amendments of 1966, 80 Stat. 242-43 (1966).

[40] 1966 S. REP., *supra* note 34, at 12 (emphasis added).

from the provisions of the 1956 Act—from entering businesses not related to banking.[41] *Board of Governors* v. *First Lincolnwood Corp.*, 99 S.Ct. 505, 512-513 (1978). A second and far more controversial purpose for the Amendments, urged by the Nixon Administration and by Federal Reserve officials, was to broaden the variety of enterprises in which bank holding companies could engage. Supporters of this liberalization argued that it would stimulate competition and create economies of scale, to the benefit of the consumer, and would permit banks to adjust flexibly to a dynamic economy.[42] On this goal the House and Senate disagreed; the struggle between them culminated in the rewriting of the bill during a Conference Committee "of great controversy and grinding negotiations and many, many offers and

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[41] In the late 1960's, this exemption suddenly began to be used as a means by which single banks could join by merger into a conglomerate structure involving various non-banking businesses. There was a widespread belief in Congress that this loophole had to be closed quickly in order to curb the rapid centralization of American industry into a few gigantic accretions of capital. *See generally*, H.R. REP. No. 387, 91st Cong., 1st Sess. 2 (1969) [hereinafter cited as 1969 H.R. REP.]; S. REP. No. 1084, 91st Cong., 2d Sess. 3-4 (1970) [hereinafter cited as 1970 S. REP.].

[42] *See Bank Holding Company Act Amendments—Hearings on H.R. 6778 Before the House Comm. on Banking and Currency*, 91st Cong., 1st Sess. 86, 88, 198 (1969) [hereinafter cited as *1969 House Hearings*]; *One Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, S. 3823, and H.R. 6778 Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 147, 169, 187 (1970) [hereinafter cited as *1970 Senate Hearings*].

counter offers in an attempt to reach agreement." [43] The product was the type of ambiguous compromise that characteristically results when parties who deeply disagree are under intense pressure to reach a mutually acceptable accommodation.

Section 4(c)(8), as amended, exempts

> shares of any company the activities of which the Board . . . has determined . . . to be *so closely related to banking or managing or controlling banks as to be a proper incident thereto.* . . .

12 U.S.C. § 1843(c)(8) (emphasis added). This language reflects concessions by both the House and Senate conferees. The Senate conferees agreed to retain the "closely related" language of the 1956 Act. The majority House conferees, as relevant to our inquiry, agreed to amend the 1956 Act's phrase "the business of banking" to read simply "banking," and agreed to delete a so-called "laundry list" of activities generally forbidden to bank holding companies.

Both the House and Senate bills, as reported, replaced the "closely related" language with a "functionally related" test.[44] This language had been proposed by Chairman Martin during the House Committee hearings, apparently as a compromise between the Administration's bill, which would have dramatically broadened the activities permitted bank holding

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[43] 116 CONG. REC. 41963 (1970) (remarks of Rep. Sullivan).

[44] 1969 H.R. REP., *supra* note 41, at 1; 1970 S. REP., *supra* note 41, at 25.

companies,[45] and Representative Patman's bill, which would have retained verbatim the standard of the 1956 Act.[46] As defined by Chairman Martin and his successor, Chairman Arthur Burns, the "functionally related" test would have been broad enough to encompass operating a closed-end investment company.[47] Despite the fact that both Houses passed bills containing the "functionally related" test, the Conference Committee returned to the "closely related" test of the 1956 Act.[48]

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[45] The Administration proposed to exempt shares of companies whose activities were "financial or related to finance in nature or of a fiduciary or insurance nature." 1970 CONF. REP., *supra*, at 19.

[46] *See 1969 House Hearings, supra* note 42, at 164.

[47] Chairman Martin's statement, *id.* at 220 (emphasis supplied), listed as a permissible activity "operating a diversified *open-end* investment company"; but given the lower level of securities activities by closed-end companies, *see* text following note 8 *supra*, the statement would appear to apply *a fortiori* to the latter. Chairman Burns listed within the "functionally related" rubric "acting as investment adviser [or] operating a 'no load' mutual fund." *1970 Senate Hearings, supra* note 13, at 142.

[48] 1970 CONF. REP., *supra*, at 5. This action reflected a compromise between the House and Senate bills. The House bill, although it incorporated the "functionally related" test, had been amended on the floor to include a "laundry list" of six activities generally forbidden to bank holding companies. *See* 115 CONG. REC. 33133-33139 (1969). The majority conferees from the House agreed, *inter alia*, to eliminate the laundry list, but only in exchange for a return to the existing "closely related" standard. *See* 116 CONG. REC. 42423 (1970) (remarks of Sen. Sparkman); *id.* at 41954 (remarks of Rep. Widnall.) The significance of the concessions by the House conferees is discussed at text accompanying notes 52-63 *infra*.

The precise significance of the retention of "closely related" is unclear. The four majority House conferees gave it great significance,[49] but the three minority House members refused to sign the statement. The Senate conferees generally downplayed its importance.[50] Courts have disagreed as to its implications.[51]

Whatever its overall significance, however, retention of the "closely related" test evidences a congressional intent that bank holding companies were not to engage in the securities business beyond what was permitted in the 1956 Act. As we have noted, the "closely related" language in the earlier statute was in all likelihood not intended to permit operation of a closed-end investment company. *See* text ac-

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[49] They argued that

> The decision of the Conferees to reject the "functionally related test" . . . is intended to be construed to mean that the Congress was not convinced that such expansion and liberalization was justified. Consequently, the Congress intends that those activities which the Board and other witnesses claim would have been permitted under the "functionally related test" . . . are not authorized by our decision to retain the "so closely related" test, which is considerably less expansive and liberal. . . .

1970 CONF. REP., *supra*, at 21.

[50] *See* 116 CONG. REC. 42422, 42424 (remarks of Sen. Sparkman); *id.* at 42427, 42435 (remarks of Sen. Bennett).

[51] *Compare* National Courier Ass'n v. Board of Governors, 516 F.2d 1229, 1236 (D.C.Cir. 1975) *with* Alabama Ass'n of Ins. Agents v. Board of Governors, 533 F.2d 224, 239 (5th Cir. 1976), *modified on other grounds*, 558 F.2d 729 (5th Cir. 1977), *cert. denied*, 435 U.S. 904 (1978).

companying notes 33-38 *supra*. The liberalized "functionally related" language, at least as interpreted by the spokesmen for the Board, would have permitted such activity. *See* note 47 and accompanying text, *supra; but see* note 58 and accompanying text *infra*. The rejection of the proposed language, and the return to the earlier standard, strongly suggests that Congress would have intended that the activity at issue in this case not be engaged in.

The "closely related" language, however, was retained only in exchange for a number of liberalizing concessions, two of which are relevant for present purposes. First, the Conference Committee amended the phrase "the business of banking" to read simply "banking." If the meaning of this change is not obvious on its face, the underlying legislative purpose is clear. The Board sought to be freed of a number of its precedents that had restrictively interpreted this phrase to encompass only activities with a direct and significant connection to the actual business of a particular bank holding company's subsidiary bank. For example, the Board had permitted bank holding companies to own a mortgage servicing subsidiary, but had limited the subsidiary's activities to the servicing of mortgages actually held by a subsidiary bank.[52] The deletion of the qualifying phrase "the business of" was suggested to the Conference Committee by Chairman Burns as a means of permitting bank holding companies and their non-bank subsidiaries to engage in activities "related to bank-

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[52] *See 1970 Senate Hearings, supra* note 42, at 201.

ing . . . generally, rather than to the specific business carried on by the subsidiary banks of the particular holding company involved." [53]

As this court has previously noted, deletion of the qualifier "the business of" significantly liberalized the strictures of section 4(c)(8).[54] Nevertheless, this change, as interpreted by its principal proponent, was designed only to permit bank holding companies and their non-bank subsidiaries to enter *markets* not served by their bank subsidiaries.[55] Nowhere was it suggested that the amendment was intended to broaden the *lines of business* permitted to bank holding companies.[56] As we have seen, however, as of 1970 Congress probably believed, with good reason, that bank holding companies could not legally operate closed-end investment companies.[57] It appears, therefore, that this particular change did not make legiti-

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[53] 116 CONG. REC. 41959 (1970).

[54] National Courier Ass'n v. Board of Governors, 516 F.2d 1229, 1236 (D.C.Cir. 1975). *But see* Alabama Ass'n of Ins. Agents v. Board of Governors, 533 F.2d 224 (5th Cir. 1976), *modified on other grounds*, 558 F.2d 729 (5th Cir. 1977), *cert. denied*, 435 U.S. 904 (1978).

[55] 116 CONG. REC. 41959 (1970) (letter from Chairman Burns).

[56] Chairman Burns' suggestion was clearly a fallback position, a statement of the minimum liberalization he would be willing to accept. In this context, it would seem incongruous to interpret the amendment so expansively as to go significantly beyond the effect claimed for it by its author and chief proponent.

[57] *See* text accompanying notes 33-38 *supra*.

mate the activities sanctioned by the Board's regulation and interpretive ruling.

A second liberalizing action by the Conference Committee was the elimination of the House bill's so-called "laundry list" of activities that bank holding companies could engage in either not at all or to a very limited extent only. One item on this list encompassed the operation of closed-end investment companies, *see* text accompanying note 60, *infra*. At first blush, then, it might appear that Congress' elimination of this prohibition constituted a specific endorsement of the Board's action challenged in this case.

The legislative history, however, tells a far different story. As was evident from our review of the Glass-Steagall Act, the abuses stemming from bank involvement in the *securities* business were the very evils against which that legislation was primarily aimed. Not surprisingly, then, although the meaning of section 4(c)(8) may be controversial in other respects, the evidence is overwhelming that Congress did not intend that provision to cut back on the prohibitions against securities activities contained in the Glass-Steagall Act.

Apparently the only participants in the legislative process even to suggest that bank holding companies might be permitted to act as investment advisers were Chairmen Martin and Burns, the spokesmen for the Board. Significantly, however, even the Nixon Administration's bills, which would have greatly liberalized the activities permitted bank holding companies in other respects, contained an explicit prohibition,

in terms nearly identical to section 19(e) of the Glass-Steagall Act, against entry into the securities business by bank holding companies.[58]

The House bill, as reported, forbade bank holding companies from acquiring the shares of any company "engaging in the underwriting, public sale, or distribution of mutual funds."[59] This provision was not stringent enough for the full House, which amended it on the floor to cover

> [e]ngaging in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds or other similar securities, or of interests in any such securities, whether or not any such interests are redeemable and whether or not the securities to which any such interests relate are in a fund or account or are subject to discretionary sale or purchase. . . .[60]

The floor amendment was incorporated as part of the laundry list that was eliminated in Conference Committee.

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[58] The Administration bills in both Houses would have barred holding companies from obtaining interests in companies "engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities." *See 1970 Senate Hearings, supra* note 42, at 98 (S.1664); *1969 House Hearings, supra* note 42, at 90, 175, 418, 549 (H.R. 9385).

[59] *See* 115 CONG. REC. 32910 (1969) (H.R. 6778).

[60] *See id.* at 33133, 33139.

Its elimination, however, did not signal its rejection by the Conferees; to the contrary, this particular part of the laundry list was *supported* by the Nixon Administration. In the words of Dr. Charls Walker, Under Secretary of the Treasury: [61]

> We could have lived with [the "functionally related"] language. Unfortunately, on the floor of the House, they went on to say that certain activities are not functionally related to banking —*one we would agree with to be excluded, the securities business. This has been traditional for years*—but listed some five or more other areas where banks already are operating and have been operating for many, many years.

During the same hearings, Dr. Walker amplified this position with specific reference to investment adviser activities: [62]

> THE CHAIRMAN [Sen. Sparkman]: During the 90th and the 91st Congresses, this committee sent to the Senate floor legislation which in both instances was adopted, allowing banks to offer commingled managed agency accounts. These are bank-operated mutual funds, which are sold without a sales charge.
>
> The House-passed one bank holding company bill would, in [Sen. Williams'] opinion, specifically prohibit such sales by holding companies.
>
> In your opinion, is such a prohibition justified? What is the Treasury Department's view

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[61] 1970 *Senate Hearings, supra* note 42, at 18 (emphasis added).

[62] *Id.* at 27 (emphasis added).

on the desirability of allowing banks to offer these mutual funds to the public?

Dr. WALKER: The Treasury Department has supported the legislation to which Sen. Williams referred . . . permitting banks in-house, the bank, to operate mutual funds. *We have not supported legislation which would allow bank affiliates to operate mutual funds, nor would this legislation change present law in that respect.*

This particular part of the laundry list was eliminated, not because the Conferees found it objectionable, but only because it was felt to be unnecessary in light of existing prohibitions in the Glass-Steagall Act. This is evident from the following colloquy, 116 CONG. REC. 42430 (1970):

Mr. WILLIAMS of New Jersey. I have one question I should like to ask the chairman of the committee.

Both the Senate and House bills contained, in section 4(c)(8), substantially similar language reiterating the existing law embodied in the Glass-Steagall Act which provides, essentially, for separation of commercial banking and the securities business. This language does not appear in the bill agreed to by the conferees. I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may nevertheless be engaged in by bank-holding companies or their nonbanking affliates.

Mr. SPARKMAN. The answer to the Senator's question is that there clearly was not. As it now stands, the Glass-Steagall Act broadly pro-

> hibits both banks and their affiliates from engaging in what we commonly understand to be the securities business. There are some specific exceptions, of course, but I can assure you that we did not mean to enlarge or contract them here. We regarded that general prohibition as being so clearly applicable to the subjects of this bill as to make a restatement of it unnecessary. The provision to which you referred is already complicated enough. In short, we did not intend to amend or modify, directly or indirectly, any limitations on the activities of banks, bank-holding companies or any of their affiliates, now contained in the Glass-Steagall Act. If Congress is to change that longstanding, fundamental statement of public policy, we will have to do so in other legislation. I hope there is no longer any misconception on that point.
>
> Mr. WILLIAMS of New Jersey. It is reassurring, indeed, to know that the Glass-Steagall Act has not been disturbed in any way and that there is no intention at all here to do so.

We do not view this colloquy as casting doubt on our conclusion in Part III hereof that sections 16 and 21 of the Glass-Steagall Act do not proscribe operation of closed-end funds by bank holding companies. Most importantly, the Senators' assumption that the Glass-Steagall Act barred securities activities by bank holding companies was in all likelihood based on section 19(e) of the Act, *see* note 22 *supra*, or possibly, on the securities affiliate provisions of sections 20 and 32, *see* notes 20-21 *supra*. Section 19(e), of course, was repealed in 1966, *see* notes 39-40 and accom-

panying text *supra;* and, needless to say, we intimate no views as to the applicability to the present case of sections 20 and 32.

Further, this colloquy is significant, not so much for what it says about the Glass-Steagall Act, but for what it implies about the 1970 Amendments to the Bank Holding Company Act. The quoted passage indicates that Congress *perceived* the Glass-Steagall Act as prohibiting securities activities by bank holding companies and their non-bank subsidiaries. Congress, of course, may have been mistaken in its perception, but this possibility has no bearing on its intent in amending section 4(c)(8) of the Bank Holding Company Act. And, as we have noted, Congress did not intend, in the 1970 Amendments, to sanction bank holding company operation of closed-end investment companies.[63]

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[63] Some of the statements in the legislative history refer to a "mutual fund", which is the popular name for an open-end investment company. It would appear, however, that the phrase was used in a rough generic sense to refer to investment companies of all kinds, rather than to open-end companies as opposed from closed-end ones. The generic usage undoubtedly stemmed from Congress' awareness of efforts on the part of national banks during that period to operate mutual funds directly. *See 1970 Senate Hearings, supra* note 42, at 27; 115 CONG REC. 32897 (1969) (remarks of Rep. Patman); *cf. ICI* v. *Camp, supra.* That closed-end companies were not meant to be excluded is evident from the House's floor amendment, *see text* accompanying note 60 *supra,* which explicitly covered "interests in . . . securities, *whether or not any such interests are redeemable. . . .*" *See also* 115 CONG. REC. 32902 (1969) (remarks of Rep. Moorhead).

Our analysis of the legislative history of section 4(c)(8) is further supported by a consideration of the policies underlying the 1970 Amendments. As we have noted, *see* text accompanying note 41 *supra*, the main thrust of this legislation was to close the one-bank holding company loophole. The burgeoning of one-bank holding companies was thought to pose two somewhat different dangers.

First, there was the danger that bank holding companies would improperly further the interests of their nonbank subsidiaries by abusing the power of their subsidiary banks.[64] Although to a considerable extent the Board's interpretive ruling reduces the likelihood of these abuses, *see* note 14 and accompanying text, *supra*, a number of evils foreseen by Congress in 1970 might not be fully protected against. The interpretive ruling does not prohibit a subsidiary bank from preferentially advancing credit to companies whose shares are owned by the controlled closed-end investment company, or from denying credit to the competitors of those companies.[65] Nor does it prohibit a subsidiary bank from disclosing confidential information about its depositors to its affiliated investment adviser.[66]

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[64] *See* 115 CONG. REC. 32891 (1969) (remarks of Rep. Bennett); *id.* at 32894 (remarks of Rep. Patman); *id.* at 32903 (remarks of Rep. Moorehead); *1969 House Hearings*, *supra* note 42, at 197 (testimony of Chairman Martin).

[65] *See* authorities cited in 64 *supra*.

[66] *See* 115 CONG. REC. 32894 (1969) (remarks of Rep. Patman).

More importantly, the Board's interpretive ruling fails to give due weight to a second evil that was thought to flow from the growth of one-bank holding companies: the centralization of economic power in the American economy. Congress was deeply concerned that the economy was becoming structured along the lines of the Japanese "Zaibatsu" system, in which economic power was concentrated in a few gigantic power centers.[67] This concern for the structural integrity of the economy would be present even if there were fully adequate safeguards against abuse of the subsidiary bank's economic power. Yet the Board's action in the present case, permitting bank holding companies or their affiliates to control the investment decisions for large pools of capital, would seem to portend the type of centralization of power that Congress feared in the 1970 Amendments.[68]

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[67] *See, e.g., 1970 Senate Hearings, supra* note 42, at 13; *1969 House Hearings, supra* note 42, at 9, 21.

This concern was reflected in the President's message to Congress accompanying introduction of the Administration bills:

> Left unchecked, the trend toward the combining of banking and business could lead to the formation of a relatively small number of power centers dominating the American economy. This must not be permitted to happen....

Statement by the President Endorsing Proposed Legislation for Further Regulation, 5 WEEKLY COMP. OF PRES. DOC. 461 (March 24, 1969).

[68] Apparently the only witness at the House or Senate Hearings who spoke directly to this question was Professor Adolf Berle. His testimony is instructive:

[Footnote continued on page 47a]

For the reasons stated above, we vacate the Board's regulation and interpretative ruling challenged in this case, 12 C.F.R. §§ 225.4(a)(5)(ii), 225.125.

It is so ordered.

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[68] [Continued]

> [A] one-bank holding company, with the resources of its bank, with the stockholding power in the bank's trust department, *and especially if it also acquires control of mutual funds which have further stock interests,* can probably attain control of any corporation in the country it really wants to get. . . .

1969 House Hearings, supra note 42, at 9 (emphasis supplied). Professor Berle also testified that

> [u]nquestionably, entry into the mutual investment field would mean that if the group that controlled the banks also controls the mutual investment funds, it could have a very large influence, perhaps a dominating influence, on the stock market. The huge institutions, by buying or selling, or refusing to buy or sell, as the case might be, in substantial measure could for a time at least determine the level of the stock market.

Id. at 28.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1978

No. 77-1862

[Filed Jul. 13, 1979]

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

BEFORE: McGOWAN and WILKEY, Circuit Judges, and GASCH, United States District Judge for the District of Columbia.

ORDER

It is ORDERED, by the Court, *sua sponte*, that the Opinion for the Court filed in the above captioned case on March 30, 1979 be, and it hereby is amended as follows:

Add the following sentence to Footnote 13:

> Under these circumstances, we do not reach, and are not to be taken as expressing any view on, the question of whether bank holding companies and their non-bank subsidiaries may, either under the present regulation or one more narrowly drawn, render

solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies.

Per Curiam

For the Court:

/s/ George A. Fisher
GEORGE A. FISHER
Clerk

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1978

No. 77-1862

[Filed Mar. 30, 1979]

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

PETITION FOR REVIEW OF AN ORDER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Before: McGOWAN and WILKEY, Circuit Judges, GASCH,* United States District Judge for the District of Columbia

JUDGMENT

This cause came on to be heard on a petition for review of an order of the Board of Governors of the Federal Reserve System and was argued by counsel. On consideration thereof, it is

ORDERED AND ADJUDGED by this Court that the Board's regulation and interpretative ruling challenged in this case are hereby vacated, in accordance with the opinion of this Court filed herein this date.

Per Curiam

For the Court:

/s/ George A. Fisher
Clerk

Date: March 30, 1979

GEORGE A. FISHER

Opinion for the court filed by Circuit Judge McGowan.

* Sitting by designation pursuant to 28 U.S.C. § 292(a).

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1978

No. 77-1862

[Filed Jul. 16, 1979]

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

BEFORE: McGowan and Wilkey, Circuit Judges; and Gasch*, Judge, United States District Judge for the District of Columbia.

ORDER

Upon consideration of respondent's (Board of Governors of the Federal Reserve System) petition for rehearing, and of petitioner's (Investment Company Institute) response thereto, it is

ORDERED, by the Court, that respondent's aforesaid petition for rehearing is denied.

Per Curiam

For the Court:

/s/ George A. Fisher
GEORGE A. FISHER
Clerk

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* Sitting by designation pursuant to Title 28 U.S.C. § 292(a).

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1978

No. 77-1862

[Filed Jul. 16, 1979]

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

BEFORE: Wright, Chief Judge; McGowan, Tamm, Leventhal, Robinson, MacKinnon, Robb, and Wilkey, Circuit Judges.

ORDER

The suggestion for rehearing *en banc* filed by respondent Board of Governors of the Federal Reserve System, and the response filed thereto by petitioner Investment Company Institute, having been transmitted to the full Court and no judge in regular active service having requested a vote with respect thereto, it is

ORDERED, by the Court, that respondent's aforesaid suggestion for rehearing *en banc* is denied.

Per Curiam

For the Court:

/s/ George A. Fisher
GEORGE A. FISHER
Clerk

APPENDIX D

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Washington, D.C. 20551

March 8, 1974

G. Duane Vieth, Esq.
Arnold & Porter
1229 Nineteenth Street, N.W.
Washington, D.C. 20036

Dear Mr. Vieth:

This is in reference to the petition dated December 12, 1973 filed by you on behalf of your client, the Investment Company Institute ("ICI"), requesting that the Board of Governors reconsider and rescind section 225.4(a)(5)(ii) of Regulation Y which authorizes bank holding companies, subject to the procedures of section 225.4(b), to serve as investment advisers, as defined in section 2(a)(20) of the Investment Company Act of 1940, to investment companies registered under that Act. The petition argues that the Board's regulation authorizes violations of two provisions of the Banking Act of 1933 (commonly referred to as the Glass-Steagall Act) and that therefore the Board acted improperly when it acted under section 4(c)(8) of the Bank Holding Company Act to permit the activity in question. The Board has considered the arguments contained in the petition and, for the reasons stated hereinafter, believes them to be without merit. Accordingly, the petition is hereby denied.

The petition alleges that there are at present 19 investment companies advised by banks and bank-affiliated institutions; these companies have sold over $1 billion in securities to the public. Of these companies, 15 are closed-end funds, three are open-end funds (participation in these three is limited to banks and other institutions) and one is technically an open-end fund but operates like a closed-end fund. Twelve of the 19 investment companies are advised by the bank subsidiaries of bank holding companies and the remainder are advised by nonbanking subsidiaries.

The principal argument contained in the petition is that section 21 of the Glass-Steagall Act (12 U.S.C. 378), which makes it a felony for a deposit-receiving institution to engage at the same time in the business of issuing, underwriting, selling or distributing stocks, bonds or other securities, is violated by the Board's regulation because "bank holding companies, their banking and nonbanking affiliates and the investment companies associated with them, must be viewed as a single entity." The Board has applied the "single entity" theory when it would further Congressional intent (for example, see 12 CFR 218.107). However, to apply the "single entity" theory in the manner suggested would, it seems, require the Board to ignore totally the structure fashioned by Congress to divorce commercial banking from investment banking when it enacted the Glass-Steagall Act. The Glass-Steagall Act contained four key sections to carry out this purpose; three (sections 20, 21 and 32, 12 U.S.C. 377, 378 and 78, respectively)

were initially new sections and the fourth (section 16) contained an amendment to Paragraph Seventh of section 5136, Revised Statutes, 12 U.S.C. 24. Briefly stated, section 21 prohibits any bank from engaging in the securities business directly, section 20 prohibits an affiliation of a member bank with an organization "engaged principally" in the securities business and section 32 prohibits interlocking relationships between member banks and companies "primarily engaged" in the securities business. As the U.S. Supreme Court observed in *Board of Governors* v. *Agnew*, 329 U.S. 441, at page 448:

> "On the other hand, when Congress came to deal with the practice of underwriters taking checking desposits, it used language different from what it used in either §§ 19 and 20 on the one hand or in § 32 on the other. By § 21 it prohibited any organization 'engaged' in the underwriting business 'to engage at the same time to any extent whatever' in the business of receiving checking deposits. Thus within the same Act we find Congress dealing with several types of underwriting firms—those 'engaged' in underwriting, those 'primarily engaged' in underwriting, those 'engaged principally' in underwriting. The inference seems reasonable to us that Congress by the words it chose marked a distinction which we should not obliterate. . ."

Furthermore, section 21 is a criminal statute and, as such, must be strictly construed. In addition, the single entity theory would require the Board to ignore the intent of Congress when it enacted the 1970

Amendments to the Bank Holding Company Act; clearly, Congres intended the Board to authorize bank holding companies to engage in activities that could not be conducted by banks directly. H.R. Rep. No. 91-1747, 91st Cong., 2nd Sess. (1970). Accordingly, the Board is of the opinion that the prohibitions of section 21 apply only to a bank and may not be held applicable to a bank holding company or a nonbank subsidiary of a bank holding company.

Furthermore, even if section 21 were held to apply to a bank holding company or a nonbank subsidiary of a bank holding company, the Board does not believe that section 21 would be violated by any action taken in accordance with the regulatory provision in question. Concurrently with the adoption of the amendment to Regulation Y to permit bank holding companies to act as investment advisers to investment companies, the Board issued an interpretation explaining the scope of such activity (12 CFR 225.125). In that interpretation, the Board clearly stated that "a bank holding company should not engage, directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser." Illustrations of prohibited sales practices were also provided in that interpretation. A review of the Exhibits accompanying the petition filed with the Board indicates that, except for the special purpose Georgia investment companies, commented on below, wherever a bank or bank holding company has acted as an investment adviser to an investment company, an independent

underwriting firm was used to distribute the fund's securities. It is suggested in the petition (page 29) that "it strains credulity to believe that such restrictions can succeed in preventing active promotion by bank holding companies and their affiliates of funds which they have created and which they sponsor and control." No evidence has been submitted, however, to demonstrate that bank holding companies or their bank or nonbank subsidiaries have engaged in sales activities with respect to the shares of such funds. In the absence of such evidence and in view of the criminal penalties for violations of the Bank Holding Company Act and the Board's regulations, it must be presumed that bank holding companies are acting lawfully.

In considering the permissibility of investment advisory activity for bank holding companies, the Board was especially careful to limit the scope of the permitted activity to investment advisory services, which has been a traditional banking function as long as there have been banks. As of December 31, 1972, over $403 billion in trust assets, including $277 billion in common stocks, were administered by banks. Although some of the same dangers cited by the United States Supreme Court in *ICI* v. *Camp*, 401 U.S. 617 (1971), may also be present with respect to the conduct of investment advisory activities, surely the Congress did not intend to prohibit banks from performing investment advisory services when it enacted the Glass-Steagall Act. Moreover, in the Board's opinion, there are several significant distinctions be-

tween the investment fund before the Court in *Camp* and the activity authorized by the Board. In the *Camp* case, interests in the investment fund were offered and sold by the bank; here bank holding companies are prohibited from that activity. Further, in the *Camp* case, it might be argued that there were promotional pressures to sell additional interests in the fund in order to prevent contraction of the fund and to increase the bank's advisory fee which was based on total assets held by the fund. However, in the case of a closed-end fund, there are no such promotional pressures on the adviser because the fund's growth results principally from increase in asset value, rather than from external growth. Therefore, the adviser's economic incentive to increase its compensation is accomplished by furnishing superior investment advice, rather than engaging in sales activities.

Further, the adoption of a dividend reinvestment plan by a closed-end fund does not, in the Board's opinion, change its character to that of an open-end fund. Securities issuances by companies pursuant to such plans are generally *de minimis* in relation to the size of the company's capital structure and, in any case, the Board does not believe the dangers that the Glass-Steagall Act was enacted to prevent are present to any significant degree with respect to such plans. Accordingly, the Board does not believe that the operations of such plans are within the prohibitions of the Glass-Steagall Act.

The four funds referred to in the petition described as "open end" investment companies require special mention. As the petition points out, investment in three of these funds, Invesco Equity Fund, Inc., Invesco Income Fund, Inc., and Temporary Investment Fund, Inc., is limited to banks and other institutions and not to general members of the public. Invesco Equity Fund and Invesco Income Fund are each a "fiduciary investment company" within the meaning of and pursuant to the Georgia Fiduciary Investment Company Act. Although technically open-end funds, the Board believes that their operation is not within the legislative purpose to which the Glass-Steagall Act was directed and it would be contrary to the public interest to invoke its sanctions to their operation. Unlike the two Invesco Funds, Temporary Investment Fund is not operated pursuant to special purpose legislation. However, Loeb, Rhoades & Co., an independent investment banking firm, is identified as the "sponsor" and "administrator-distributor" of the Fund. As far as can be determined, the Fund's investment adviser, Provident National Bank, acts only as the Fund's investment adviser and as transfer agent, dividend disbursing agent and custodian of its assets, all of which are within the scope of the Board's permitted activities (12 CFR 225.125). (In any case, as discussed further hereinafter, the Board's regulation and accompanying interpretation does not apply to investment advisory services by "banks".) Lastly, although Peachtree Equity Securities, Inc. is technically an open-end investment company, since

its shares are redeemable at net asset value at any time, the prospectus relating to its initial public offering states "After completion of this offering, Peachtree will not continuously or frequently offer its shares." To the Board's knowledge, this representation has been complied with. Accordingly, the Board believes that for Glass-Steagall Act purposes, Peachtree Equity Securities, Inc. should be considered a closed-end fund.

The second argument in the petition is that, where the activities authorized by Regulation Y are undertaken by national banks or by State banks that are members of the Federal Reserve System, they violate section 16 of the Glass-Steagall Act. That provision states, in pertinent part, as follows: "The business of dealing in securities and stock by the [national banking] association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers and in no case for its own account, and the association shall not underwrite any issue of securities or stock . . ." (12 U.S. 24(7)). Section 335 of Title 12 of the U.S. Code applies this restriction to State member banks. The Board understands your argument to be that because of these provisions, a national or State member bank may not place an order with independent broker-dealer firms for the sale or purchase of stocks or other securities for the investment portfolios of funds for which they render investment advice and that because the Board's regulation permits such activity, it is invalid.

First, it is important to note that the Board's regulation was adopted pursuant to section 4(c)(8) of the Bank Holding Company Act and authorizes investment advisory activity to be conducted by a nonbanking subsidiary of the holding company. The authority of national banks or State member banks to furnish investment advisory services does not derive from the Board's regulation; such authority would exist independently of the Board's regulation and its scope is to be determined by a particular bank's primary supervisory agency. The Board's interpretation of the scope of the investment advisory activity to be permitted (12 CFR 225.125) does define bank holding company to include "both their bank and nonbank subsidiaries." However, the restrictions contained in the interpretation on operations of banking subsidiaries were only intended to apply where the investment advisory function was being conducted by a nonbanking subsidiary of the bank holding company. Accordingly, even *assuming arguendo* that national or State member banks that act as investment advisers to investment companies would violate section 5136 in doing so, this would not be a reason for invalidation of the Board's regulation; such banks are not acting pursuant to the Board's regulation when they perform such activity.

The Board has, however, addressed itself to the substantive question presented since it is the primary Federal bank supervisory agency for State member banks of the Federal Reserve System, although it does not presume to speak for the Comptroller of the

Currency who is the primary bank regulator for national banks. As noted above, banks historically have furnished investment advice to trust accounts; these include testimentary trusts, *inter vivos* trusts, executorships and guardianships, managing agency accounts and pension and profit sharing trusts. In all of these traditional trust activities, banks place orders with independent broker-dealer firms to buy and sell stocks and other securities. The petition suggests that this service may not be performed for closed-end investment companies advised by member banks since these funds are "created" by the bank and, therefore, are not "customers" of the bank. If this reasoning were to be adopted, every trust that was suggested or which was reviewed by a bank officer prior to execution of a trust instrument might be said to be a creation of the bank and, therefore, not a customer. Obviously, the Board cannot adopt a strained construction of a statute that would lead to an unreasonable result. *U.S.* v. *American Trucking Association*, 310 U.S. 534 (1940). Further, there is no reason to believe that Congress intended to impute a narrow meaning to the term "customer" when it enacted section 16 of the Glass-Steagall Act. The purpose of this provision was to restrict the power of banks to deal in securities for their own account but leave unimpaired the previously recognized authority of banks to buy or sell securities for the account of customers. S. Rep. No. 77, 73rd Cong., 1st Sess. 16 (1933). In brief, in the Board's opinion, orders placed by a State member bank for the sale or pur-

chase of stock or securities for the account of an investment company advised by the bank or by a bank holding company affiliate constitutes a transaction for the account of a "customer" and is not prohibited by Paragraph Seventh of section 5136, as applied to State member banks by ¶ 20 of section 9 of the Federal Reserve Act.

The Board also considered and rejected the argument in the petition that certain indemnification provisions, whereby banks and bank holding company affiliates have indemnified the underwriter of a fund's securities against certain liabilities, including liabilities under the Securities Act of 1933, have rendered the bank or bank holding company affiliate an "underwriter" for Glass-Steagall purposes. The indemnification provisions in question are of the usual, routine type common to most securities underwritings whereby a party which has furnished information to be included in a prospectus agrees to be responsible for the accuracy of such information. To the Board's knowledge, neither the Securities and Exchange Commission nor any other administrative or judicial authority has determined that the existence of such an indemnification provision would make the indemnifying party an underwriter for purposes of the statutes administered by the Commission. In any case, in the Board's judgment, it would not further the purposes of the Glass-Steagall Act to adopt such an interpretation here.

In its consideration of the petition, the Board also considered your request that the Board conduct a

hearing upon notice to interested parties. Prior to adoption of the regulatory provision at issue, the Board granted a petition of your client, ICI, for a hearing and you, on behalf of your client, participated extensively in that hearing which was held on November 12, 1971. Some of the same arguments that are contained in the petition were made at that hearing and they were considered by the Board at the time of its adoption of section 225.4(a)(5)(ii). In the Board's judgment, there are no facts in dispute that need be resolved by a hearing nor does it appear that a hearing would serve any useful purpose. Further, an additional hearing at this time is not required by the Bank Holding Company Act or the Administrative Procedure Act. *BankAmerica Corporation* v. *Board of Governors*, F. 2d. (9th Cir., January 29, 1974); *Federal Power Commission* v. *Texaco, Inc.*, 377 U.S. 33 (1964). Accordingly, the Board has denied your request for a hearing.

Very truly yours,

/s/ Theodore E. Allison
THEODORE E. ALLISON
Assistant Secretary of
the Board

APPENDIX E

Petition of Investment Company Institute for Reconsideration and Recision of a Regulation of the Board, 12 C.F.R. § 225.4(a)(5)(ii)

ORDER

On January 29, 1972, the Board promulgated a regulation, 12 C.F.R. § 225.4(a)(5)(ii), and interpretive ruling, 12 C.F.R. § 225.125, by which it determined that the activity of serving as an investment advisor, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act is closely related to banking and thus a permissible activity for bank holding companies to engage in, subject to the procedures set out in the Board's Regulation Y, 12 C.F.R. § 225. 37 *Federal Register* 1463-1464 (1972). Notice of the rulemaking had been duly given in the *Federal Register* on August 25, 1971, 36 *Federal Register* 16695, and on September 1, 1971, 36 *Federal Register* 17514; and a public hearing on the matter was held on November 12, 1971.

On December 12, 1973, the Investment Company Institute ("ICI"), Washington, D.C., the national association for the American mutual fund industry, filed with the Board a petition for reconsideration and recision of 12 C.F.R. § 225.4(a)(5)(ii). The Board duly considered ICI's petition and, by letter dated March 8, 1974, the Board denied the petition and responded in detail to the arguments that ICI

had raised. ICI thereafter sought judicial review of the Board's order denying its petition for reconsideration. However, the United States District Court for the District of Columbia dismissed ICI's petition for review in an order dated July 30, 1975, 398 F. Supp. 725; and the Court of Appeals subsequently affirmed the District Court's order of dismissal for lack of subject matter jurisdiction, 551 F.2d 1270 (D.C. Cir. 1977). Nevertheless, the Court of Appeals, having determined that the state of the law of jurisdiction was not clear at the time ICI filed its previous petition, determined that ICI should have the opportunity to file a second petition for reconsideration and recision of the Board's regulation.

Pursuant to the Court's order ICI has filed a second petition for reconsideration and recision with the Board. The petition is accompanied by a memorandum containing ICI's legal arguments and by affidavits setting out facts in support of the petition. In addition, ICI has requested that the Board convene a formal hearing pursuant to the Administrative Procedure Act and that ICI's most recent petition be determined on the record of such a hearing. ICI has not protested or filed comments with respect to any application by a bank holding company for permission to engage in the activity described in 12 C.F.R. § 225.4(a)(5)(ii).

The additional facts presented by ICI with the present petition are to the same effect as the facts presented with ICI's previous petition for reconsideration: a number of banking organizations are giving

investment advice to investment companies registered under the Investment Company Act of 1940. However, as with ICI's previous petition to the Board, most of the investment advisors identified by ICI are commercial banks, as distinguished from bank holding companies, which did not seek the Board's prior approval pursuant to 12 U.S.C. § 1843(c)(8) and 12 C.F.R. § 225 before commencing the subject investment advisory activities.[1] The Board's regulation governs the investment advisory activities of bank holding companies and their nonbanking subsidiaries. The conduct of commercial banks in this area is subject to administrative sanction at the Federal level by the Comptroller of the Currency (as to national banks) and the Board (as to state member banks); but such supervision is exercised without regard to the Bank Holding Company Act or the challenged regulation. ICI and courts before which ICI has argued have recognized these distinctions in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971) and in *New York Stock Exchange and Investment Company Institute* v. *Robert Bloom*, No. 76-1235 (D.C. Cir., decided July 19, 1977). Although the national banking organizations in those cases, whose activities were alleged to be in violation of the Glass-Steagall Act, were holding company subsidiaries, it

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[1] All seven of the open-end funds identified on page 12, footnote 6 of ICI's Memorandum are advised by banks; and the Board has no record of the filing of any application under the Bank Holding Company Act relating to these activities. In addition, 8 of 12 funds identified on page 7, footnote 2 of ICI's Memorandum are advised by banks or subsidiaries of banks.

is clear that the courts as well as ICI viewed the Comptroller as the appropriate regulatory authority to consider the Glass-Steagall Act questions. Nevertheless, ICI asks the Board to rescind its regulation although the activity being complained of is being conducted chiefly by banks and the Board was not asked to approve, and in fact did not approve the activity pursuant to Regulation Y.[2]

ICI's most recent petition also suggests that the Board consider the circumstances surrounding the

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[2] ICI claims that the Board's previously expressed position that the challenged regulation and interpretation do not cover the activities of commercial banks "involves, as a practical matter, an illusory distinction." However, as the United States Court of Appeals in the District of Columbia Circuit stated with respect to the Board's determination that a certain other activity is closely related to banking, "[t]he order under review does not itself authorize any particular bank holding company to engage in courier activities." *National Courier Association* v. *Board of Governors*, 516 F.2d 1229, 1233 n.4 (D.C. Cir. 1975). To give investment advice *pursuant to the challenged regulation*, a company must file an application pursuant to 12 C.F.R. § 225. That the commercial bank advisors identified by ICI have failed to do so merely evidences the fact that their activities are not subject to the regulation and are not being engaged in pursuant thereto. The fact that some of the investment funds thus advised cite the Board's interpretation in their securities registration statements may indicate an acceptance of the Board's distinction between open-end and closed-end companies for purposes of determining whether affiliated investment companies "engaged principally" or "primarily engaged" in the securities business and thus whether sections 20 and 32 of the Glass-Steagall Act were violated. The logic of ICI's position would require approval under the Bank Holding Company Act of almost all corporate activities carried out by banks directly. This Congress clearly did not intend.

formation of certain open-end funds which purport to be sponsored by brokerage organizations and to receive only investment advice from various bank affiliates of bank holding companies; the circumstances surrounding the organization and subsequent open-end conversion of Advance Investors Corporation; the feasibility as a commercial matter that investment funds can and will select banks as advisor without bank participation in the creation of the fund; and the desirability of regulating and prohibiting certain relationships between bank holding company affiliates and firms which sponsor or administer funds, such as the placement of brokerage, extensions of credit, and business referrals.

In presenting the above suggestion of topics to be considered by the Board, ICI does not raise issues of material fact that are appropriate for resolution by the Board in this proceeding. ICI notes that at least seven open-end investment companies created since ICI's previous petition are advised by commercial banks and that such banks have undertaken to restrict their activities with respect to such funds to the giving of investment advice. But ICI, which suggests the banks may have illegally sponsored these funds and indicates the banks place brokerage with the nominal sponsors, does not indicate that these activities are being engaged in pursuant to the Board regulation here challenged by ICI. All seven investment advisors named are banks, and no applications for prior approval of these activities were filed with or considered by the Board under § 4(c)(8) of the

Bank Holding Company Act and the related regulations.[3]

ICI also reiterates its previous position that bank holding companies should not be permitted to sponsor closed-end funds. However, in support of its contention ICI indicates that a certain closed-end fund recently converted itself into an open-end fund. ICI argues that if the bank sponsor intended to open-end the fund from the day the fund was created, sections 16 and 21 would have been violated; but ICI admits "we presently have no reason to suspect that the foregoing is what actully happened."

As set forth more fully below, the Board has determined that a formal hearing is not required or approriate in the present case. Neither the Administrative Procedure Act, 5 U.S.C. § 551, *et seq.*, nor the Bank Holding Company Act, 12 U.S.C. § 1841 *et seq.*, requires that the Board's rulemaking proceedings be governed by formal procedures such as those used in judicial trials and administrative adjudications. In fact the latter statute has been amended by Congress to provide that the Board's proceedings need not be held "on the record"; and this amendment has the effect of preserving the Board's ability to use informal rulemaking procedures. See, *e.g.*, *Independent*

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[3] Although some of the named banks are state member banks, the Board has not been asked by ICI to determine whether such banks are violating the Glass-Steagall Act through the named activities, but only whether their activities can be viewed as closely related to banking under a statute, section 4(c)(8) of the Bank Holding Company Act, on which they have not relied in commencing these activities.

Bankers Association of Georgia v. *Board of Governors*, 516 F.2d 1206 (D.C. Cir. 1975).

The Board has also determined that informal hearing procedures, like those used by the Board when it considered adoption of the challenged regulation in 1971, are not required for full and fair disposition of ICI's most recent petition for reconsideration and recision of 12 C.F.R. § 225.4(a)(5)(ii). ICI fully participated in the hearing held in this matter prior to adoption of the regulation. The question raised by ICI—whether the challenged regulation and interpretive ruling allow bank holding companies to violate sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. §§ 24 and 378—is a legal question and was considered in the Board's deliberations leading to adoption of the regulation and in response to ICI's previous petition for reconsideration. Finally, ICI has presented no new facts which raise issues of material fact for resolution by the Board; and as discussed hereinafter the Board has concluded that the factual inquiries suggested by ICI are best left for later adjudicatory proceedings which may, depending on the circumstances, require use of formal or informal hearing procedures. Such adjudicatory proceedings must be held before any bank holding company may engage in the activity described by 12 C.F.R. § 225.4 (a)(5)(ii). See generally 12 C.F.R. § 225.4.

In support of its request for a hearing, ICI cites several judicial decisions in which courts of appeals have determined that hearings were appropriate on applications by bank holding companies for permis-

sion to engage in activities previously determined by the Board to be closely related to banking. *Alabama Association of Insurance Agents* v. *Board of Governors*, 533 F.2d 224 (5th Cir., 1976); *Independent Bankers Association of Georgia* v. *Board of Governors*, 516 F.2d 1206 (D.C. Cir. 1975). ICI argues that it would be entitled to a hearing were it opposing such an application, and that it should have a hearing in this case because the Court of Appeals recognized that ICI's interest in the Board's regulation extends beyond the facts of any particular application. However, these cases and ICI's argument appear to support the Board's conclusion that ICI's proposed factual inquiries should be resolved in later adjudicatory proceedings.

ICI apparently recognizes that the Board must determine two questions with respect to section 4(c)(8) and that the second question, the "public benefits" question, is the one that creates the need for a factual inquiry. Memorandum in Support of Petition for Reconsideration, pp. 32-33. In discussing its proposed factual inquiries, ICI states:

> "We submit, therefore, that Section 225.4(a)(5)(ii) requires reconsideration not only to prevent the direct sponsorship of closed-end funds in violation of the Glass-Steagall Act, as we have previously contended, but also to avoid another problem: that is, situations involving open-end funds which may not on their face demonstrate Glass-Stegall violations, but which *depending on the facts*, may indeed involve violations. In any event, these situations also pre-

> sent the possibility of a clear conflict with the Board's responsibilities under the Bank Holding Company Act to avoid 'undue concentration of resources, decreased or unfair competition [or] conflicts of interest. . . .' 12 U.S.C. § 1843(c)(8)." [Emphasis supplied]

Memorandum, pp. 20-21. It is thus clear that ICI is asking the Board to apply the "public benefits" test of section 4(c)(8) in the context of an industry-wide rulemaking. ICI's allegations, however, go to the facts of particular operations by individual companies and how they bear on the public benefits aspects. See *National Courier Association* v. *Board of Governors*, 516 F.2d at 1233. Moreover, it is not clear whether the banking organizations identified in ICI's most recent petition would intervene in any hearing convened by the Board at this time, since most such organizations are not engaging in investment advisory activities pursuant to 12 C.F.R. § 225.4(a)(5)(ii); and it is not apparent how the factual inquiries proposed by ICI can be pursued absent such intervention. None of these organizations intervened in the lawsuit that preceded ICI's filing of the present petition. The present petition for reconsideration of a rule does not involve "resolution of conflicting private claims to a valuable privilege." *Action for Children's Television* v. *United States*, No. 74-2006 (D.C. Cir., decided July 1, 1977). For the

foregoing reasons, the request for a hearing should be, and it hereby is, denied.[4]

The next question presented for the Board's consideration is whether the Board should reconsider and rescind 12 C.F.R. § 225.4(a)(5)(ii). ICI argues that the challenged regulation and interpretation authorize bank holding companies to violate sections 16 and 21 of the Glass-Steagall Act. Among other things, ICI claims that bank holding companies and their banking subsidiaries are single entities, and that sections 16 and 21 are violated by the activities of such companies engaged in pursuant to the Board's regulations.

In its previous orders in this matter—37 *Federal Register* 1463-1464; letter of March 8, 1974, from the Board's Secretary to ICI's counsel—the Board dealt with ICI's contentions on the merits in considerable detail. After due consideration of the present

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[4] ICI indicates it is aware of the Board's weekly press release (Form H-2) and *Federal Register* notice summarizing each action taken and application received by the Board during the week covered by these notices. See above Memorandum in Support of Petition for Reconsideration, p. 10. ICI may challenge any future application to the Board for permission to advise open-end or closed-end funds by responding to such notices or to the *Federal Register* or publication notices given on each such application to the Board. If any activity previously authorized by the Board has led to Glass-Steagall Act violations in spite of the safeguards and restrictions in 12 C.F.R. § 225.125, ICI may petition the Board to institute cease and desist proceedings pursuant to 12 U.S.C. § 1818, or may refer alleged criminal violations of the Act directly to the appropriate United States Attorney, or may simply itself sue the offending banking organization. *New York Stock Exchange and Investment Company Institute* v. *Robert Bloom*, No. 76-1235 (D.C. Cir., decided July 19, 1977).

petition and of those previous orders, and of the entire record that has been made in this proceeding, the Board believes its previous orders were legally and factually correct. Accordingly, the Board hereby reaffirms its previous orders in this matter and incorporates both orders by reference herein.

In what appears to the ICI's principal attempt to present "any relevant information which is developed in the interim" (since the Board's consideration of ICI's first petition for reconsideration), as suggested by the Court of Appeals, ICI alludes to information which suggests banks acting as investment advisors regularly place brokerage transactions with the brokerage houses which have been designated as the sponsors of the funds that they advise (Memorandum, pages 19-22). ICI then proceeds to argue that this may involve "undue concentration of resources, decreased or unfair competition [or] conflicts of interest . . ." which are factors that the Board must consider under section 4(c)(8). ICI thereupon states "If the Board were to prohibit or restrict the placement of brokerage by a bank holding company subsidiary with a firm which sponsors a mutual fund for which the subsidiary acts as investment advisor and otherwise regulate or prohibit transactions between the two entities, it would be possible to be far more confident that the selection and retention of banks as investment advisors to funds they allegedly do not 'sponsor' will be based upon proper competitive considerations."

In the Board's view ICI's argument in this regard is without merit. In the passage just cited, it would appear that ICI is admitting that the new open-end funds are sponsored and controlled by the brokerage firms, rather than the bank advisors.[5] Furthermore, the obligations of a fund's directors with respect to selection of its investment advisor are clearly spelled out in the Investment Company Act of 1940 and Congress recently considered at length and enacted legislation dealing with the question of selection of brokerage firms by money managers as part of the Securities Acts Amendments of 1975 (15 U.S.C. 28(e)(1)); Sen. Rep. 94-75, pp. 69-71). Accordingly, the Board believes that this subject matter is fully covered by existing law and that it would serve no useful purpose to consider the matter at this time in discharging its responsibilities under the Bank Holding Company Act.

The Board has placed conditions upon the investment advisory activities of bank holding companies and their nonbanking subsidiaries designed to prevent the occurrence of Glass-Steagall Act violations as a result of such activities. 12 C.F.R. § 225.125. For example, bank holding companies may advise

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[5] In addition, on page 20 of its Memorandum, ICI also states "Thus, while the ranks of directors and officers of the new open-end funds may be dominated by personnel asosciated with the brokerage house and not with the bank, some doubt arises as to the practical likelihood that the decision to retain the bank as investment advisor to the fund will in all instances be made objectively on the basis of capabilities and performance, without consideration of the substantial benefits which the bank is in a position to confer upon the brokerage house."

but may not sponsor open-end investment companies because such companies may be said to be "engaged principally" or "primarily engaged" in the securities business through the issuance of securities on a more or less regular basis. Moreover, bank holding companies may affiliate with closed-end investment companies only "as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities. This is consistent with —and even stricter than—the provision of section 20 of the Glass-Steagall Act which merely prohibits affiliations with a member bank where a company is "engaged principally" in securities activities.

In addition, the Board stated in its interpretive ruling that the provisions of the Glass-Steagall Act are not affected by the Bank Holding Company Act Amendments of 1970 (84 Stat. 1760), and that the Board's regulation and the interpretative ruling are consistent "with the spirit and purpose of the Glass-Steagall Act. . . ."

> It is clear from the legislative history of the Bank Holding Company Act Amendments of 1970 (84 Stat. 1760) that the Glass-Steagall Act provisions were not intended to be affected thereby. Accordingly, the Board regards the Glass-Steagall Act provisions and the Board's prior interpretations thereof as applicable to a holding company's activities as an investment advisor. Consistently with the spirit and purpose of the Glass-Steagall Act, this interpretation applies to all bank holding companies registered under the Bank Holding Company Act irrespective of

> whether they have subsidiaries that are member banks.

12 C.F.R. 225.125(b). The Board also stated that bank holding companies may not undertake any activity prohibited by the Glass-Steagall Act:

> The Board intends that a bank holding company may exercise all functions that are permitted to be exercised by an "investment advisor" under the Investment Company Act of 1940, except to the extent limited by the Glass-Steagall Act provisions, as described, in part, hereinafter.

12 C.F.R. 225.125(d). Pursuant to 12 U.S.C. § 1818, the Board may issue cease and desist orders to restrain violations of law by bank holding companies, including violations of the Glass-Steagall Act. The Board is prepared to use this authority where it appears that a bank holding company has violated or is violating 12 C.F.R. § 225.4(a)(5)(ii) or any of the limitations on investment advisory activities specified in 12 C.F.R. § 225.125. If ICI is aware of any such violations of law which merit investigation by the Board or the institution of cease and desist proceedings pursuant to 12 U.S.C. § 1818, it should advise the Board accordingly. In addition, ICI may seek intervention in any future proceeding arising out of an application by a bank holding company for permission to give investment advice pursuant to 12 C.F.R. § 225.4(a)(5)(ii), if it believes the applicant bank holding company may violate the Glass-Steagall Act. ICI thus has the same remedies available to it in this case as it has with respect to the bank invest-

ment service activities that it challenged in *New York Stock Exchange and Investment Company Institute* v. *Robert Bloom*, No. 76-1235 (D.C. Cir., decided July 19, 1977), as well as the additional remedy of being able to seek intervention in future adjudicatory proceedings under the challenged regulation.

For the foregoing reasons, ICI's petition for reconsideration and recision of 12 C.F.R. § 225.4(a)(5)(ii) should be, and it hereby is, denied.

By order of the Board of Governors,[6] effective August 31, 1977.

(Signed) Theodore E. Allison
THEODORE E. ALLISON
Secretary of the Board

[SEAL]

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[6] Voting for this action: Vice Chairman Gardner, and Governors Wallich, Jackson, Partee and Lilly. Absent and not voting: Chairman Burns and Governor Coldwell.

APPENDIX F

Federal Register notice of January 29, 1972 publishing the amendment to Section 225.4(a) of Regulation Y and the interpretive ruling accompanying said amendment

TITLE 12—BANKS AND BANKING

CHAPTER II—FEDERAL RESERVE SYSTEM

SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. Y]

PART 225—BANK HOLDING COMPANIES

Nonbanking Activities of Bank Holding Companies

By notice of proposed rulemaking published in Federal Register on August 25, 1971 (36 F.R. 16695), the Board of Governors proposed to add to the list of activities that it has determined to be closely related to banking or managing or controlling banks (§ 225.4(a) of Regulation Y) the following: "serving as investment adviser to an investment company registered under the Investment Company Act of 1940". A hearing on this proposal was held on November 12, 1971, after a notice thereof was published in the Federal Register on October 29, 1971 (36 F.R. 20779).

Following consideration of the comments received and the record of the hearing, the Board has amended § 225.4(a), effective February 1, 1972, to add the

new activity, with a minor modification in language from that proposed, to its list of permitted activities.

An accompanying interpretation expresses the Board's views on several questions, which arose during the course of its consideration of this matter, concerning the scope of the new activity and the applicability of certain provisions of the Banking Act of 1933 (48 Stat. 162) thereto.

The text of the amendment to § 225.4(a) reads as follows:

§ 225.4 NONBANKING ACTIVITIES.

(a) *Activities closely related to banking or managing or controlling banks.* * * * The following activities have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto:

* * *

(5) acting as investment or financial adviser, including (i) serving as the advisory company for a mortgage or a real estate investment trust; (ii) serving as investment adviser, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act; and (iii) furnishing economic or financial information; **

** For an interpretation relating to the scope of the activity described in (ii) see 12 C.F.R. 225.125. Acting as a management consultant is not regarded by the Board as within this activity (5). Whether to propose expanding activity (5) to include management consulting is under consideration by the Board.

Effective date: February 1, 1972.

By order of the Board of Governors, January 20, 1972.

(Signed) Tynan Smith
TYNAN SMITH
Secretary of the Board

[SEAL]

TITLE 12—BANKS AND BANKING

CHAPTER II—FEDERAL RESERVE SYSTEM

SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. Y]

PART 225—BANK HOLDING COMPANIES

Nonbanking Activities of Bank Holding Companies

§ 225.125 INVESTMENT ADVISER ACTIVITIES.

(a) Effective February 1, 1972, the Board of Governors amended § 225.4(a) of Regulation Y to add "serving as investment adviser, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act" to the list of activities it has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. During the course of the Board's consideration of this amendment several questions arose as to the scope of such activity, particularly in view of certain restrictions imposed by sections 16, 20, 21 and 32 of the Banking Act of 1933 (12 U.S.C. 24, 377, 378, 78) (sometimes referred as the "Glass-Steagall Act provisions") and the United States Supreme Court's decision in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971). The Board's views with respect to some of these questions are set forth below.

(b) It is clear from the legislative history of the Bank Holding Company Act Amendments of 1970 (84 Stat. 1760) that the Glass-Steagall Act provisions were not intended to be affected thereby. Accordingly, the Board regards the Glass-Steagall Act provisions and the Board's prior interpretations thereof as applicable to a holding company's activities as an investment adviser. Consistently with the spirit and purpose of the Glass-Steagall Act, this interpretation applies to all bank holding companies registered under the Bank Holding Company Act irrespective of whether they have subsidiaries that are member banks.

(c) Under § 225.4(a)(4), as amended, bank holding companies (which term, as used herein, includes both their bank and nonbank subsidiaries) may, in accordance with the provisions of § 225.4(b), act as investment advisers to various types of investment companies, such as "open-end" investment companies (commonly referred to as "mutual funds") and "closed-end" investment companies. Briefly, a mutual fund is an investment company which, typically, is continuously engaged in the issuance of its shares and stands ready at any time to redeem the securities as to which it is the issuer; a closed-end investment company typically does not issue shares after its initial organization except at infrequent intervals and does not stand ready to redeem its shares.

(d) The Board intends that a bank holding company may exercise all functions that are permitted to be exercised by an "investment adviser" under the

Investment Company Act of 1940, except to the extent limited by the Glass-Steagall Act provisions, as described, in part, hereinafter.

(e) The Board recognizes that presently most mutual funds are organized, sponsored and managed by investment advisers with which they are affiliated and that their securities are distributed to the public by such affiliated investment advisers, or subsidiaries or affiliates thereof. However, the Board believes that (i) the Glass-Steagall Act provisions do not permit a bank holding company to perform all such functions, and (ii) it is not necessary for a bank holding company to perform all such functions in order to engage effectively in the described activity.

(f) In the Board's opinion, the Glass-Steagall Act provisions, as interpreted by the U.S. Supreme Court, forbid a bank holding company to sponsor, organize or control a mutual fund. However, the Board does not believe that such restrictions apply to closed-end investment companies as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities. In no case, however, should a bank holding company act as investment adviser to an investment company which has a name that is similar to, or a variation of, the name of the holding company or any of its subsidiary banks.

(g) In view of the potential conflicts of interests that may exist, a bank holding company and its bank and nonbank subsidiaries should not (i) purchase for their own account securities of any investment company for which the bank holding company acts as

investment adviser; (ii) purchase in their sole discretion, any such securities in a fiduciary capacity (including as managing agent); (iii) extend credit to any such investment company; or (iv) accept the securities of any such investment company as collateral for a loan which is for the purpose of purchasing securities of the investment company.

(h) A bank holding company should not engage, directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser. Prospectuses or sales literature should not be distributed by the holding company, nor should any literature be made available to the public at any offices of the holding company. In addition, officers and employees of bank subsidiaries should be instructed not to express any opinion with respect to advisability of purchase of securities of any investment company for which the bank holding company acts as investment adviser. Customers of banks in a bank holding company system who request information on an unsolicited basis regarding any investment company for which the bank holding company acts as investment adviser may be furnished the name and address of the fund and its underwriter or distributing company, but the names of bank customers should not be furnished by the bank holding company to the fund or its distributor. Further, a bank holding company should not act as investment adviser to a mutual fund which has offices in any building which is likely to be iden-

tified in the public mind's with the bank holding company.

(i) Acting in such capacities as registrar, transfer agent, or custodian for an investment company is not a selling activity and is permitted under § 225.4(a)(4) of Regulation Y. However, in view of potential conflicts of interests, a bank holding company which acts both as custodian and investment adviser for an investment company should exercise care to maintain at a minimal level demand deposit accounts of the investment company which are placed with a bank affiliate and should not invest cash funds of the investment company in time deposit accounts (including certificates of deposit) of any bank affiliate.

(Interprets and applies 12 U.S.C. 1843(c)(8).)

By order of the Board of Governors, January 20, 1972.

(Signed) Tynan Smith
TYNAN SMITH
Secretary of the Board

[SEAL]

APPENDIX G

RELEVANT STATUTORY PROVISIONS

1. 12 U.S.C. 24 Seventh provides in pertinent part:

> * * * The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock * * *.

2. 12 U.S.C. 221a(b) provides:

> Except where otherwise specifically provided, the term "affiliate" shall include any corporation, business trust, association, or other similar organization—
>
> > (1) Of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; or
> >
> > (2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares

voted for the election of directors of such bank at the preceding election, or by trustees for the benefit of the shareholders of any such bank; or

(3) Of which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one member bank; or

(4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of a member bank at the preceding election, or controls in any manner the election of a majority of the directors of a member bank, or for the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees.

3. 12 U.S.C. 377 provides in pertinent part:

After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities: * * *.

4. 12 U.S.C. 378 provides in pertinent part:

After the expiration of one year after June 16, 1933, it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor: * * *.

5. 12 U.S.C. 1843(a) provides in pertinent part:

Except as otherwise provided in this Act, no bank holding company shall—

(1) after the date of enactment of this Act acquire direct or indirect ownership or control of any voting shares of any company which is not a bank, * * *.

6. 12 U.S.C. 1843(c) provides in pertinent part:

The prohibitions in this section shall not apply to

* * * * *

(7) shares of an investment company which is not a bank holding company and which is not engaged in any business other than investing in securities, which securities do not include more than 5 per centum of the outstanding voting shares of any company;

(8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern;

* * * * *

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